CHAPTER - 1

STATEMENT OF PROBLEM AND CONCEPTUAL FRAME WORK
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Introduction.

Accounting is a service activity. Its main purpose is to provide quantitative financial information for decision making in a business. The accounting activities form a progression of steps beginning with observing, then collecting, recording, analysing and finally communicating information to its users viz, creditors, investors, Government, trade unions, management and researchers etc. In other words accounting process involves the accumulation, analysis, measurement, interpretation, classification and summarization of the results of each of the many business transactions that affect the business concern. Such financial information is usually reported to the various users through the financial statements which are prepared based on certain accounting concepts and conventions. A concept is known to be an abstract idea serving a systemizing function (Kohler)\(^1\). Convention, on the other hand, refers to a statement or rule of practice which by common consent expressed or implied is employed in the situation of a given class of problems or guides behaviour in a certain kind of situation\(^2\).

The existing accounting practice of preparation of financial statements are based on an important accounting concept namely the monetary concept. Money is common measuring unit of transactions which are recorded in the books of account. Only those transactions which can be measured in money are taken into consideration recording in the books of account. In India, this measuring monetary unit in ‘rupee’ (dollar in the
U.S.A. and pounds in the U.K.) etc., is stable and that fluctuation in value of money may be ignored in the preparation of accounts. But with the change in the value of money due to inflation the assumption of a stable monetary unit does not hold good and creates a number of problems in the preparation of accounts in various ways, thus, the subject of inflation accounting now a days has received a wide attention in financial accounting due to inflation prevailing in many countries in the world. Because of the increase in prices, a demand has been made accounting that business enterprise should prepare inflation adjusted financial statements in place historical cost based financial statements. Since this historical cost accounting does not contain useful information to satisfy the needs and purposes of management as well as external users. Historical cost accounting also known as conventional accounting, records transactions appearing in both the profits and loss account and balance sheet in monetary terms which reflect their historical cost. Historical cost is a concept that relates to the cost was actually incurred or the amount was actually paid in acquiring the assets or services. Historical cost, therefore, means the original cost or the acquisition cost. The historical principle requires that accounting records which are maintained at original transaction prices and these values are retained though out the accounting process to serve as the basis for values in the financial statements. Also, the historical cost accounting is based on the realisation concept which requires the recognition of revenue when it has been realized. The realisation concept has an important implication affecting both the profit and loss account and the balance sheet. This concept requires that only realised revenue should be included in the income statement.
The historical cost accounting has certain advantages. It is considered free from bias, more reliable and independently verifiable. It reduces to a minimum the extent to which the accounts may be affected by personal judgments of those who prepare them. It is the only legally recognised accounting system accepted as a basis of taxation, dividend declaration etc. Finally, historical cost accounting is least costly to society considering the costs of recording, preparing, reporting and auditing.

However, historical cost accounting is suffered from serious limitations.

Firstly, the historical accounting is based on the assumption of stable monetary unit, which assumes that there is no inflation. This assumption does not prove true during inflation which changes are found in general price level or specific price level.

Secondly, it does not match current revenues with current costs of operations. While some costs like wages and other operating expenses reflect current costs but the other costs like of goods sold and depreciation may not represent the current costs. Accordingly, historical cost accounting results to report overstated profit during a period of increasing prices. This overstated profit in historical cost accounting is not the real profit but exaggerated and illusory. Because as per the historical cost convention, fixed assets of an enterprise are taken for depreciation purpose to have been purchased at uniform prices though in practice they are purchased at various prices in the past. The total amount of depreciation provided over the working life of the asset is equal to the original money cost of asset if we assume that the scrap value of the asset is nil. Then it is obvious that there would be no difficulty in financing the replacement of the used up asset if the prices have not changed. But with the changes in prices replacement of assets
becomes difficult. It is so because the depreciation provision based as it is on the original money investment in fixed assets represents an amalgam of cost incurred at various points of time and does not represent the same amount of purchasing power as was originally invested in the assets exhausted during the operation. This results that when the level of prices goes up the historical cost basis of depreciation provision causes a gap between the annual depreciation provision and the cost of the used up portion of the asset both measured in terms of purchasing power. Such difference is cumulative in nature over a long period of time and leads the firm into critical position to replace fixed assets.

Thirdly, the balance sheet prepared on the basis of historical cost accounting does not truly represent the resources held by an enterprise at the balance Sheet because on the balance sheet the assets are represented at lower amounts because fixed assets are recorded at the original monetary costs invested at the time of their acquisition.

Fourthly, another factor responsible for causing distortions to historical cost accounting is the cost of inventory which is shown at cost or market price which is lower. Sales, on the other hand, are shown at current purchasing power of the rupee. Thus, profit disclosed by financial accounting based on historical cost accounting does not represent increase in wealth of business in terms of the current purchasing power because inventory is not realistically valued at their current value.

Finally, the other factor responsible for distortions to historical cost accounting is purchasing power gains and losses which occur simply because a concern is holding some monetary liabilities and assets. These results gain or lose purchasing power during inflation. These gains and losses are in the nature of costs of holding monetary assets and
liabilities and should be taken into account which considering the effects of price charges on historical cost accounting.

In view of the above mentioned drawbacks of historical cost accounting, there is a need to restructure historical cost based financial statement or to develop alternative accounting system for accurate measurement of profit and reliable reporting of financial position. Inflation adjusted financial statements would not only achieve the objective reliable profit and financial position measurements but would also prove useful to management and external users in their decision making. Since the high rate of inflation that has gripped almost all the economics of the world has forced different users such as corporate managers, accountants, academics, investors, government etc., to give a fresh look and consider whether the corporate accounts prepared on historical cost basis serve the purpose they are supposed to and whether some changes in accounting system is warranted. With a view to overcoming the problems related to the historical cost accounts a number of proposals has been made to incorporate the effects of inflation accounting. In some countries of the world, notably UK, USA, and Canada the proposals have taken a definitive form and are already being implemented. In India also, a loud thinking is going about useful and suitability of the historical cost accounting in the context of higher the rate of inflation. Since the majority of the business enterprise in India does not seem to have made any worth mentioning attempt, a few of them have been attempted to incorporate the effects of inflation in their accounts.

Therefore, in view of the great significance of the subject for the business enterprises and its far-reaching implications for other users and the society at large a need
is felt for the present study. The study will therefore examine the existing system of accounting, suggest ways to provide inflation adjusted information to users and explore the possibility of adopting on long term basis a system of accounting which has built in mechanism for adjusting to the changes in prices. The evaluation of corporate practices regarding financial accounting and reporting during inflation will be made.

**Statement of Problems**

The existing accounting practices also called traditional or historical cost accounting are based on the monetary concepts while implies these monetary units in statement and that fluctuation in it may be ignored in the preparation of accounting. So long as prices and costs remain stable, no accounting problem a raised. But the movement upward and downward in the price level, a host of problems being to creep into the historical cost accounts. During inflation profits are overstated and assets costs are understated. Conversely, there is under statements of profits and overstatements of assets during deflationary conditions change in the value of the monetary items, which are ignored by historical cost accounting. In consequences interpretative value of these accounts is reduced. The financial statements fail to serve the purpose for which they are designed. To sum up such distortions deprive the users of accounts of the information which enables them to study the operating results and judge the effect of price level changes of the firm.

But the present study attempts to clarify the nature of the problem associated with historical cost accounting during the period of Inflation. We shall explain the orthodox approach to the account analyse the basic results which causes distortion to the historical
cost accounts result and examine major problems of historical cost accounting when the
price level are changing.

The monetary postulates under the orthodox, conventional or historical cost
accounting does not hold good during the period of inflation. Hence a host of problem is
being to creep into the accounts with the movement of upward or downwards in price
level. Such problems have the effect of distorting the accounting results in various ways
such as overstatement of profits and understatement of assets during the period of price
level changes. Conversely, there is understatement of profits and overstatement of assets
when the price level is falling. This distortion due to rising price level in the historical
cost accounts interacts into the accounts through basic factors namely depreciation on
fixed assets and cost of inventories confined. Another factor is the purchasing power gain
or loss on the monetary items of the firm.

The point at which the rising price levels are apt to have a great impact upon the
financial statements is the depreciation on fixed assets. Under the existing accounting
practice fixed assets of an enterprise are taken for depreciation purpose to have been
purchased at uniform price level. So long as there is no change in the value of monetary
unit, the amount of total depreciation provided over the working life of the asset in use
would be equal to the original work cost of the asset (assuming the scrap value is nil).
Therefore, there is no difficulty in financing the replacement assets when the need arise.

A similar through less insidious problem exists in relation to the accounting of
inventories. The inventories which form the part of the cost of sales are valued at their
original acquisition cost or market price whichever is lower but they are matched in the
profits and losses account with the sales revenue at current prices. Consequently the reported profits become swollen by a capital element representing inventory gains. Besides the distortion in reported profit figures such tendencies also give arise to the problem of replacement of inventories. The reported cost of inventories realised as a part of the sale proceeds would be insufficient to replace the same quality of inventories if the prices are raising.

The another important factor which should be considered in any attempts to throw light on the effects of the problem of price level changes on the financial statements is the purchasing power gains or losses on the monetary unit of the firm. Such gains and losses occur simply because the firm is holding some monetary assets and liabilities which lose or gain purchasing power during changing price level. These gains or losses are in the nature of costs of holding monetary assets and liabilities and should be taken into account while analysing the effect of price level changes on historical cost accounting.

Here, we would examine the problem, which arise under the historical cost accounting during the period of Inflation.

It is an accepted principle that the exhaustion of fixed assets and the consumption of current assets involved in the operation of the business should be considered in the nature of cost and that sufficient provision out of current revenues should be made so as to recover fully the purchasing power equivalent of the used up portion of the assets. As pointed out, both a short provision of depreciation and incorrect matching of cost of inventories consumed mean that costs of carrying on business have not been fully
recovered. This causes a financial strain and ultimately the firm finds itself without adequate where with to support its operations.

Another problem which arises in price level changes in historical accounts is the problems of replacement. The firm finds it gradually more difficult to replace business assets because of the non-recovery, as costs, of exhaustion of fixed assets and the consumption of inventories. This problem is quite serious in respect of fixed assets because under the historical cost accounting, the total amount of depreciation provision over the useful life of the asset does not represent the same amount of purchasing power as was originally invested in the asset in use. In other words we can say that the amount of historical cost depreciation accumulated over the useful life of the asset falls short of the current replacement cost of the assets. This deficiency in depreciation provision turns out to be a financial problem in replacement of assets whether by a similar asset or an entirely new asset. It is felt that such a deficiency in depreciation provision should originally be meet out of the net retained profit which is subject to tax.

The problem of replacement of inventories on the other hand is a little less acute. This is so because in practice very little opportunity is allowed for a accumulated deficiency to occur over time. Inventories are almost immediately replaced after their use. The difficulties of replacement of inventories are nonetheless real and may create considerable financial strain on business carrying large inventories during the period of pronounced inflation.

The historical cost accounting treatment of inventories and depreciation creates financial strain on the business and the firm begins to feel, over time, the shortage of
funds. The cost of inventories forming part of the cost of sales is matched with the sale
revenue at current prices. In consequence, a gap develops between the amount needed to
replace the used up inventories. Thus, inflation leads to the shortage of working capital
and constant inflation involves constant drawing into the business of additional working
capital or switching over from other current assets to inventories in order to finance
replacement. Deficiency in depreciation provisions on fixed assets which leads to the
shortage of fixed working capital is another source of financial strain during inflation.
With the passage of inflationary period, the firm finds that it has exhausted a substantial
part of its capital by way of taxes, bonus and dividend payments.

Taxation of capital is another problem associated with historical cost accounts
during the period of changing price levels. The historical cost treatment of inventory and
depreciation during inflationary conditions leads to overstatement of profits represented
by capital element consisting of inventory gain and deficiency in depreciation provision.
The taxation of such portion of historical cost profits to distribution out of capital, more
clearly, its amounts to 'living' on capital. Hence there is further erosion of working capital
and consequent financial strain on the business.

The effect of inflation on the interpretative value of financial statements is much
pronounced and it is more frequently put forward as an argument in favour of deviation
from the existing historical cost accounting system. There are two important aspects of
this problem, are worth mentioning.

Firstly, during the period of prolonged inflation various items of the balance sheet
are based on different levels of costs and prices and hence they are not comparable in any
real sense. In the profits and losses account, inventory profits and similar capital gains get inextricably mixed with operating profit thus making the proper assessment of the earning capacity of the firm difficult if not possible. In a nutshell, the financial statements become difficult to interpret and their use as a tool of managerial decision-making is much lessened. Prof. K.C. Lacey rightly observed that "the accounts based on historical cost set an unsatisfactory, impossible standards for business managers. While during the period of rising price levels it is easier for business management to show considerably good results it is very difficult during falling price levels to earn sufficient profit to cover costs incurred when price levels were perhaps much Higher."

Secondly, such financial statements apt to mislead the shareholders and other users. The concept of 'profit' and 'maintains of capital' based on the monetary postulates make the shareholder believe that so long as their money capital is maintained, their interest in the company are fully protected. This belief is, however, erroneous and quite misleading. The real interest of shareholders lies in the yield from business as a going concern and in the eventuality of its winding up in its actual break up value as opposed to apparent book value. As a consequence of these interpretative difficulties, shareholders and other investors are not provided with information, which enables them to interpret the operating results and to judge the relative effect of price level changes upon a particular enterprise. Such inability arising due to interpretative difficulties of historical cost accounting to properly assess the business position may result in lost business opportunities.
Rationale of the study

Although the problem of accounting during the period of changing monetary values has been a subject of much discussion in a large number of American and European countries for the past seven-half decades particularly no attention has been made to this subject in our country. Even today the Indian scene both academics and business appears rather in different to an effective solution of the problem. This state of affairs assumes special significance in view of the fact that our country has been seriously affected by inflationary price rise during the past thirty years or so. Such conspicuous absence of consciousness and attention towards the problem of price level accounting is attributable among others to the following important reasons.

(1) The size of the corporate sector in our country had been comparatively small in the past. Hence the problems due to price level changes were not so significant and could assume national importance.

(2) The large-scale joint stock companies in India are of recent origin. Then companies have not yet come across the acute financial problem of replacing the fixed assets, which are either still now or need no replacement at present.

(3) The process of technological changes has been slow in our country with result that the replacement of fixed assets is not so rapid here as it is in industrially advanced countries.

(4) The Indian industrial scene during the first half of this century was dominated by large number of small sized business units having short life span and the management of most of these units consisted of owners, entrepreneur, managers. This lead the entrepreneurs in the past protect their short term interest. The taxes during those days
were also not as high and they are today so that taxation of inflated profits did not seem necessary burden to the business.

(5) Unfortunately, serious thinking on the problems of adjusting HCA for price level changes has been rather senate in academic and professional circles in our country. Original work on the subject did not attract much professional attention during the last three decades. The academicians, practicing accountants, branch managers and entrepreneur have shown very little interest either in undertaking case studies to gauge the magnitudes of the problem created in accounts by price level changes or in developing suitable techniques to deal with the problem. This is quite surprising when one find that systematic work on price level accounting organized as early as 1936 with the publication of Sweeny’s stabilized Accounting in West Germany. Since then a lot of research and experimentation has been carried out in a number of countries particularly the U.K., the U.S.A., Canada and Australia.

(6) The professional industries of the country Institute of Chartered Accountants of India (ICAI) and Institute of Cost and Works Accountants of India (ICWAI) are also to share the blame, as they did not take this problem in real earnest. One important reason for such passive attitude appears to be absence of rapport between these institutions and industry.

The above account makes clear the need and rational of undertaking the present empirical study with the purpose of bring to light the impact of changing price level on the financial accounts prepared according to existing accounting practices.
Object of the study

The object of the proposed study is to measure and record, by analysing methods, the effects of price level changes on the historical cost accounting (HCA) of selected Indian companies. The study focuses attention on significant aspects of the problem of price level changes in HCA and in particular attempts:

1. How business enterprises deal, if at all, with price changes in their accounts?
2. What items of the financial statements are considered for this purpose?
3. How is the price-adjusted information shown in the financial statements?
4. What accounting techniques are adopted to account for inflation and how far they are useful or satisfactory?
5. How is such information useful to external users?
6. What are the corporate responses to price changes i.e.,
   (i) If price changes are not considered in the preparation of financial statements, what are the main considerations for it?
   (ii) How are price changes dealt with in budgeting and managerial decisions?
   (iii) Are pricing decisions linked, in any way, to changes in costs and prices?
   (iv) Is the annual depreciation charge based on a consideration of price changes?
   (v) Have the assets of the company been revalued at any time for purposes other than that of insurance?
7. What is the corporate attitude and thinking towards the problem of price changes in accounts? In particular:
   (i) What method of inflation accounting is the most preferred one?
(ii) What items of financial statements and what types of prices should be considered for adjustments?

(iii) How should price-adjusted information be shown?

(iv) What is the rationale for introducing inflation accounts in India?

Scope of Study

The present work is a case study of four undertakings, selected from public sector. The main factor responsible for selection of the four units was limitation of times resources and availability of satisfactory data. The four industries selected for the study are capital incentive where there is likely to be greater investments in fixed assets and inventories - the items which are most affected by price level changes.

The four undertaking selected for this study belong to public sector. These are:

1. Ashok Leyland Limited.
2. Bharat Heavy Electricals Limited.

Hypotheses

In view of the objectives of the study, my hypotheses are that:

1. In India, the concept of Inflation Accounting and its practical application has taken a back seat so far as its relates to the corporate world.

2. There are certain valid reasons behind the non-adoption of inflation accounting techniques in their preparation and presentation, of inflation accounting information by the Indian Corporates.
3 There are a few exceptions to the rule and now-a-days a number of organisations have started presenting their financial statements along with adjustments with the change in prices.

4 This practice is bound to grow with the time and once its utility in business decision making is ascertained and confirmed there will be a large number of business entities who will adopt measures to reflected price changes in their financial presentation.

Research Methodology.

To test the above hypotheses I would rely on the published annual reports, books, journals, statements etc., of the selected industries which will form the main source of information. Besides questionnaire was canvassed to collect information in such accounting practices as depreciation method, inventory valuation make price level accounting practices and similar accounting information generally not available in the annual reports. The information so gathered was supplement when found necessary by arranging personal interview with financial executives of the undertaking under study.

Plan of Study

The study has been divided into five broad chapters so as to highlight the main aspects of the probe as well as its related issues.

- The first chapter Statement of problem and conceptual framework deals with the statement of problem, its objectives, scope of the study, review of literature and research methodology.
• The second chapter provides the various approaches and theories of inflation accounting deals with current purchasing power method (CPP), Current Cost Accounting (CCA) Specific and General Price Level Accounting (SPLA).

• The third chapter present the inflation accounting practices in Abroad deals with General price level changes, in United State of America, United Kingdom, Canada, France, Belgium, Sweden, Japan, Germany, Australia and Italy.

• The fourth chapter attempts to discuss inflation accounting practices in India's corporate sector.

• The fifth chapter is the concluding chapter of theme, which would give the summary of conclusion and would provide suggestions and recommendation and also suggest practical model of inflation accounting for future use by corporates in India.

Limitation of the Study

The present work is based on the information obtained from the published annual reports of the undertaking. Efforts were made to elicit as much as possible by means of questionnaire and personal interviews with the senior executives. However, non-availability of transactions wise financial information in some cases the use of arranging and approximate the result of our study is also influenced by the limitations of wholesale price index number which has been used for adjustment purpose.

Review of Literature

Inflation accounting which has become a important and constant fact of life in may countries of the world has received wide attention by accounting academicians and
professionals in financial accounting in the last few decades. Inflation accounting is a
generic expression connoting any of the phrases likes accounting for prices level Changes
(APC) price level accounting, replacement cost accounting, current cost accounting
(CCA), general purchasing power accounting (GPPA) etc. Researches of United States of
America, United Kingdom, Australia and Canada have given serious thought to this
problem and has conducted various researches in this field. They have also
recommended some tools to fight against the effect of inflation on the historically and
traditional accounting practices. The available foreign studies on this subject have been
reviewed in the following paragraphs.

H.W. Sweeny in his publication known as Sweeny’s Stabilised Accounting
published as early as 1936 in West Germany studied Inflation Accounting a systematic
way in the early part of this century. In his publication he proposed an accounting
technique to deal with changing price level.

A study conducted by the American Institute of Certified Public Accountants
(AICPA) in 1948, felt that no basic change in the accounting treatments of depreciation
of plant and equipment is practicable under present conditions to meet the problem
created by the decline in the Purchasing power of dollar. Such a change would confuse
readers of financial statements and nullify may of the gains that have basis made towards
clear presentation of corporate finance. The AICPA in 1963 advocated inflation
accounting very seriously in a study entitled “Reporting the Financial Effects of Price
Level Changes”. About six years later, the accounting Principles Board of AICPA
published its Statement No.3 in June, 1969 on Financial Statements restated for general
pries level changes”. The Financial Accounting Standard Board (FASB) was formed in 1973. It prepared a few exposure drafts and brought out some standard most notables among them is Financial Accounting Standard (FAS)-33 issued by it in 1979. Besides, the Securities and Exchange Commission (SEC) also contributed to the discussion by issuing ‘Accounting series release (ASR) 190” to provide additional information on the estimate cost of replacing the inventories etc. In spite of these expository papers and tremendous amount of discussions that have been provoked there appears to be very low degree of consensus as to the exact method of Inflation Accounting to be adopted. Until very recently SFAS-33 was emerging as the correct accounting for price level changes (APC) standard in the U.S.A. But in December 1986 another Standard was issued entitled SFAS-89 by the FASB, which emerges as the latest APC standard in the U.S.A.

A study conducted by Institute of Chartered Accountants in England and Wales published in January 1973. As a companions to the Exposure draft (ED 8) on “Accounting for Changes in the Purchasing Power of Money” issued by the Accounting Standard Steering Committee (ASSC). The Exposure Draft (ED 8) was debated at length and in May 1974 it was followed by ASSC’s Statement of Standard Accounting Practice (No. 7 in a series of SSAP’s). This document, provisional in its nature, required the quoted companies to provide inflation adjusted accounts prepared under historical conventions.

Sandilands, F. E. P., in his report known entitled “Sandilands Committee Report” London 1975 studied that the first recorded statement on Accounting for Price Level Changes (APC) in the Accounting principle No.12 released by the Institute of Chartered
Accountant of England and Wales (ICEAW) in January, 1949. After those may statements and standards were issued on the subject till the inflation accounting committee was appointed. The Government of U.K. set up a Inflationary Accounting Committee in January, 1974 under the Chairmanship of F.E.P. Sandilands the then Chancellor of the Exchequer in the United Kingdom. The object of this Committee known as Sandilands Committee to study the effect of the inflation on accounts and suggest remedial measures. The Sandilands Committees presented its report to British parliament in 1975, and recommended the current cost accounting (CCA) a the device to reflect the affects of inflation. Based on Sandilands committee Report, the Accounting Standard Committee (ASC) issued Exposure Draft 18 in November, 1976. ED-18 required the companies to give inflation-adjusted accounts in the primary financial statements, however due to some technical flows Ed-18 was shelved and fresh discussion started in this regard. Then accounting Standard Committee appointed a committee popularly known as Hyde Committee in 1977. The Committee issued the guidelines known as Hyde Guidelines in 1978. In 1979, it was proposed that "Hyde Guidelines" should be made mandatory. According to this report, additional information containing three adjustments restating historical cost in terms of current costs namely (1) Depreciation (2) Cost of Goods sold and (3) Financial Leverage is to be given. To resolve the controversy about the adjustment of Financial Leverage, the Committee was reconvened with Douglas Morpeth as Chairman. It submitted Exposure Draft-24 in April 1979, which contained proposal for revising the gearing adjustment, recommended by Hyde Committee. It also suggested a farther adjustment of monetary working capital. The
proposal of ED - 24 with minor modifications and classifications were embodied in
remained as the current APC standard despite many shortcomings leveled against it.
Exposure Draft (ED)-35 was issued in 1985 as a proposed successor to SSAP-16. In
Netherlands (Holland) also APC for companies was encouraged. Some big multinationals
based on that country have been preparing inflation adjusted supplementary accounting
statements in addition to usual conventional historical cost accounting based financial
statements since a long time.

U.K. 1975 discussed that accounting grew up as a day by day record of business dealings.
Its figures are a series of snapshots, each a glimpse of some event as it happen. They are
faithful history. But usually they are left as historical records; the accountant does not
touch them up when conditions change at later times. For instance, he continues to
measure assets and inputs at their original costs, no matter how far their current values
have mode. Particular during inflation, the values are apt to move a long way. So now the
question is whether the accountant should not try to update his figures. One can imagine a
science-fiction society in which money's purchasing power and the relative worth of
assets never vary. In such a sleep setting, historical accounts would be admirable. In the
world as we know it, they invite criticism. With inflation, the criticism has grown loud.
When prices are rising briskly, traditional accounts are best by several ailments: their
asset values become anachronisms; they ignore important forms of appreciation and loss,
and an invisible error creeps into income measurement so that income is overstated in
profit and loss account and then in tax assessments. Therefore, he discussed the pros and cons of reform. He sets out the various proposals for improvement asset revaluation, measurement of loss on holding money, adjustment of input costs with price indices and so on. He used the term 'price change' in two senses. The first is general change that is such widespread change in the prices of goods and services that one can say the purchasing power of the money unit has altered as during inflation. The other change is in the price of individual goods or service (with or without general change) this may be called specific or special change. Both are great important for accounting.

An article entitled "The State of Current Value Accounting" by Edgar O Edwards, in 1975 observed the demonstrate and likely volatility of price during this decade suggests a review of current value accounting is in order, where it stands today and what its future might be. The literature indicates a substantial acceptance of current value accounting in accounting theory, but an impressive lack of implementation in accounting practice. The promotion of practical application obsessively needs executive direction, why else would a quality product remain on the shelf. Nevertheless, which current value accounting seems to have found a grouping number of adherents to its principle, there are yet some major differences many rough edges, and a few blind alleys exposed in the theoretical literature. The author first to indicate the currency of the subject, them to bring out some of the conceptual issues involved in current value accounting next to discuss some of the valuation issues, and finally to identify some of the potential analytical users of the current value data.
An article entitled "Current Cost Accounting -Some Basic Problems" by Fisher, John published in U.K. 1976 make a comprehensive study of Accounting Price Level Changes (APC) standard is SSAP-16 which was issued in March 1980. Although it is mandatory and calls for a complete set of current cost statements including an income statement and balance sheet many companies have shown reservation in complying with it. Despite very high degree of resistance or reservations shown by the companies it survived because it (SSAP -16) has many strong points in favour of it. Firstly, it is honorable because a government appointed committee (The Sandilands Committee, 1975) in the U.K. has recommended the use of this accounting technique to over come the distortions caused in accounts by changes in price levels. Secondly, the view of the committee that earnings and assets of a firm should be measured by reference to valuation is quit logical and justified. Thirdly, the CCA recognises that it is the current cost only that should be deducted from current income in order to extract the earning for a given period. Fourthly, Separation of holding gains (difference between the current value of assets and its original cost) from operating profit/earning enables the management to evaluate its performance. Fifthly, the break up of details of values of assets and liabilities as given under the CCA method represents a more accurate and realistic approach as to the financial position.

The book of inflation Accounting- A Guide for the Accountant and the Financial Analyst written by Sidney Davidson, Clude P. Stickney and Roman L. Well in U.S.A. in 1976 studies that our economy in recent years has experienced steady rising prices. There is every expectation that price increases will continue. Financial reporting that
recognizes this economic fact of life is coming. There are various ways of seeking to reflect this increase in prices in the accounts. Probably the most widely discussed type of reporting is variously known as "financial reporting in units of general purchasing of power", general price level adjusted accounting or if you are not fond of it. "PUPU (purchasing power unit) Accounting". We tend to desirable it as general price level adjusted accounting or GPLA accounting for short. It has also come be known as inflation accounting - thus the title of this book. The most persistent and significant complaint about accounting in recent years is that ignores in economic fact of life. Throughout the world, a steady and rapid upward movement in prices has occurred during the last few years. This has probably been the single most important economic phenomenon of 1970's. Yet this significant fact goes unrecognized today under general purchasing power accounting throughout the English speaking world. And is similarly ignored or effectually dealt with in the accounting procedures much of the rest of the world. Changing are coming in accounting and financial reporting. They discussed three methods of accounting for inflation: (i) historical dollar, conventional accounting, (ii) current value accounting and (iii) general price level adjusted accounting based on historical cost.

In comparing each of the three methods with conventional financial statements, they draw the following conclusions: GPLA financial statements change the amount but not the timings of revenues, expenses, gains and losses. They are objective and verifiable but do not disclose relevant current economic data expect for the gain or loss on holding monetary items. Current value statements without price level adjustment change the
timing but not the ultimate amount of revenues expenses gains and losses. These statements reflect change in economic conditions the occur but they may require subjective and hence hard to audit, estimates to current values. If we had to choose between one of these two methods of the accounting for inflation, we would prefer the latter which is based on current values. The two choices are not mutually exclusive, however and a combination of current values and GPLA is the best in our view. Such statements change both the amount and timings of revenues; expenses gains and losses when compared to conventional statements but the balance sheet totals are the same as on current value balance sheet. Such statements are perhaps the most useful because they provide information that is meaningful and comparable.

Arie Baran, Josef Lakonishok and Aharon R Offer\textsuperscript{13} in 1980 in their article entitled "The Information Content of General Price Level Adjustment Earnings: Some Empirical Evidence" observed that this study explores the extent to which general price level restated data contain information not included in currently available historical cost data. The criterion employed is the relative degree of association between alternative accounting measures of the extent to which a give information set is related to the broader set underlying investors decisions. The result obtained in this study appear to support the hypothesis that price level restated data contain information which is not included in the financial reports currently available.

Edward V McIntyre\textsuperscript{14} in 1982 in their article entitled "Interaction Effects of Inflation Accounting Models and Accounting Techniques" explain the choice of accounting techniques as well as evaluations of accounting numbers, are based in part
upon a knowledge of the relative profit patterns associated with alternative techniques. It is generally understood that Inflation Accounting models change profit patterns, and the general effects of changes from historical cost accounting to various inflation accounting models have been analysed. In addition to these general effects, however, there are specific effects due to the interactions of conventional accounting techniques such as Last in First Out (LIFO) and First in First Out (FIFO) and specific inflation accounting models. This study analyses the interaction effects of conventional inventory accounting methods and several inflation accounting models to demonstrate that these effects can produce significant and non-intuitive changes in relative profit patterns among alternative accounting techniques.

Walter B. Meigs and Robert P. Meigs in 1983 in his book entitled "Accounting—The Basis for Business Decisions" discussed on "Inflation—The Greatest Challenge to Accounting" they define inflation as either an increase in the general price level or a decrease in the purchasing power of the money (Dollar). The general price level is the weighted average of the prices of all goods and services in the economy. Changes in general price level are measured by general price index with a base year assigned a value of 100. The index compares the level of current prices with that of the base year. They studied that the techniques for restating financial statements for change in the general price level has been known for many years. Yet despite support from both the FASB and the APB, the preparation of constant dollar financial statements has not become a wide spread practice. Current Cost Accounting is much newer idea and appears to be gaining acceptance in many countries. The British Government has given approval to system of
current cost accounting and has arranged for development of methods to implement it. In the Nederland, large corporations are basing depreciation on replacement cost and determine cost of good sold in terms of replacement values. In Australia, the Institute of Chartered Accountants has gone on records as favoring the valuation of Assets at current cost and the measurement of profit by stating both revenue and expenses at current values. They also explained that one factor contribution to support for current cost accounting is that constant dollar financial statements are based upon the general price level and not upon the price of specific goods and services. On the other hand a significant advantage of constant dollar accounting is its high degree of objectivity. Since all adjustments are may by using the same general price index, valuations are not based on estimates or personal opinion. Also, the constant dollar accounting and current cost accounting easy convey different types of useful information. Both approaches may be used with in the single set of financial statements. In all probability, the gradual modification of the accounting process to disclose more clearly the effect of inflation will involve continuing experimentation with both constant dollar and current cost accounting. Therefore, the greatest single challenge to the accounting profession today is to develop new accounting methods that will bring financial statements into accord with the economic reality of an inflationary environment.

Wilfre Hingley and Frank Osborn16 London 1983 in heir book entitled "Financial Management Made Simple" separate chapter discussed on "Accounting under Inflationary Conditions" that basically inflation refers to the falling value of money and its outward characteristic is a general increase in prices of all goods and services. It is
fundamentally caused by an undue increase in the quantity of money in proportion to buying power. They also expressed that the effects of inflation upon a business are briefly be described as distorting its profit performance and valuation of its capital which in turn affects the judgments and decision of its management in addition its shareholders, investors and creditors.

Nunley, Terry James (1983) in his thesis has studied that the FASB has indicated that it will reconsider the present requirement for disclosing the effects of changing price after experience has been gathered with the present standard. Comprehensive adjustment of financial statements for the effects of changing prices may be required and the auditor’s responsibility may be expended to include an opinion on the adjusted financial statements or the supplementary disclosure. To determine whether the disclosures of the effects of changing prices could be successfully subjected to the audit process, it was necessary to examine the methods of employing audit evidence for historic cost based financial statements. By using the assertion classifications contained in SAS No. 31, the study examined the types of evidence available to prove an assertion. The assertion which change significantly are those of valuation and allocation.

Al-Tassan, Mohammad Saleh (1983) in his work has studied to determine of information adjusted for general inflation (Constant Dollar), as presented in accordance with FASB Statement No. 33, are more useful to investors and creditors in predicting future cash flows to the enterprise than the traditional historical cost accounting information. Cash flow is chosen in this study, as the event of interest, because of the
emphasis on the cash flow prediction by official accounting pronouncements in recent years.

Swenson, Charles William (1984) in his thesis has studied that the inflation often causes U.S. Corporations to overpay their income taxes. This tax overpayment is caused by misstatements of cost of goods sold and depreciation and by the omission of the monetary gains and losses. Five corporate tax systems are compared to an inflation neutral tax system to determine their relative ability to correct the inflationary effects on taxation. The tax systems are Brazilian, Chilean, and Argentine laws, the current U.S. tax subject to the depreciation and investment tax credit provisions of the Economic Recovery Tax Act (ERTA) of 1981, and prior U.S. tax law.

Graves, Oliver Finley (1985) in his thesis has studied that the matter of inflation accounting has occupied accounting standard setting bodies' worldwide since the early sixties. The Germans, however, apparently were the first to develop comprehensive approaches to the problem. These approaches arose in response to the decade long period of inflation that began in Germany with World War I and culminated in the hyperinflation of 1922-23. The approaches include both price level adjustment and current value models and are contained in several book length studies by three of Germany's most prominent writers in the areas of economics, accounting and finance in the 1920's. Eugen Schmalenbach of the University of Cologne, Fritz Schmidt of the University of Frankfurt, and Walter Mahlbery of the University of Freiburg in Breisgau. Objective of this study is to examine the approaches to the problem of inflation accounting developed by the Germans and assess their relevance to the situation in the
United States today. As a matter of principle, the studies relies on original German source material. In keeping with their authors’ academic backgrounds, the writing of the three Germans display a broadly theoretical orientation. Accordingly, the study first present each German’s economic and / or general accounting theory and than explicates his inflation accounting model as a logical extension of his overall theory. In order to enhance characterisation of and distinction among the models, the study notes the criticisms of each writer of each other’s model.

An article entitled “The Inflation Accounting Cycle: A British - Australian Comparative Perspective by Burrows, G./ Rowles, T. in 1998 21 This paper seeks to extend understanding of the ‘accounting-cycle’ hypothesis by comparing the Australian, and United Kingdom (UK) experiences with inflation accounting. The existence of ‘cycles’ in accounting standard setting was first suggested in respect of inflation accounting by Mumford (1979), and subsequently generalised by Nobes (1991). The paper confirms that the most of the phases identified by Mumford in respect of inflation-accounting cycles in the UK are, broadly, also identifiable in Australia. The Australian experience also largely confirms in relation to inflation accounting Nobes’ generalised, cyclical model of standard setting in which change is driven by stake holders with conflicting attitudes towards the degree of standardisation of treatments proscribed by accounting standards. While loss of interest in inflation accounting in the UK is held in the Mumford approach to result from a decline in the level of inflation, we argue that in Australia inflation continued at a high rate after interest in inflation accounting ceased. A counter hypothesis is suggested: that interest in inflation accounting would have waned in
the UK irrespective of the level of inflation. Although the Australian evidence supporting Nobes's cyclical concept is quite strong, detailed analysis of the attitudes and behaviours of the various stakeholders in inflation accounting standards is more diverse than assumed by Nobes. Complicating UK-Australia comparisons are different socio-economic environments and differing political responses to the problem of financial reporting under high levels of inflation. The nature of these differences, and the manner in which they may have affected inflation accounting standard setting is explored. Further, we argue that the atypical character of inflation accounting makes it dangerous to draw too many parallels between inflation accounting and other, more singular accounting problems, in the context of developing accounting standards.

In India serious thinking on having to adjust historical cost accounts to price level changes has been rather few and far between.

Gupta Ramesh\textsuperscript{22} in 1976 in his book entitled "Inflation Accounting" explain that the SSAP-16 came into effects since January 1, 1985 and is applicable to all the listed and unlisted companies except those small nonrealistic companies which satisfy at least two of the following three criteria namely (a) turnover is less than $ 5 million per annum, (b) balance sheet total in historical cost accounts at the beginning of the period is less than $250000, (c) average number of employees is less than 250. The Standard also exempts the value-based companies (e.g. insurance, investment, real state etc.) and wholly owned subsidiary companies besides nonprofit making entries such as charities, friendly societies, trade unions and pension funds. The current cost accounts may either be regarded as the main accounts, which are supplemented by the H.C. Accounts or vice
versa, or the CCA Accounts may be presented at the only accounts but accompanies by adequate historical cost information. Thus, the Standard provides for current cost information, which is included in annual financial statements in addition to historical cost information. The information should show the effect of Current Cost adjustments namely, Depreciation adjustment (DA), Cost of Sales Adjustment (COSA), Monetary Working Capital Adjustment (MWCA) and Gearing Adjustment (GA). In addition gross current cost of fixed assets and inventories and accumulated current cost depreciation should be disclosed separately. Finally, the Accounting standard Committee (ASC) of the U.K., has in the beginning of the year 1986 proposed to the six major accountancy bodies in the U.K., that SSAP -16 should be withdrawn.

Sinha S.L.N. 23 in his study on the Impact of Inflation on Company Finance noted that with respect to the Reserve Bank study of 350 companies with an aggregate paid up capital and reserve 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 19790-71, profit before tax rose by less than 3 per cent. Again while in 1972-73 the index number of wholesale prices was about 10 per cent higher than 1971-72, profits before tax declined fractionally, by about 0.25 per cent. If profits after tax were taken into account, the position would be far worse. To conclude, these companies could not take benefit of the inflationary price rise in the country and thus a strong ase for adjusting company accounts on the basis of historical values to their current prices, emerges to show a more realistic picture.
Porwal L.S., and Mishra, N. investigated into corporate practices in inflation accounting in India. They approached 235 large private and public sector companies in India through questionnaires sent by mail and through personal interviews. 80 companies out of 275 companies responded to their study, which is 34 per cent of the total sample. These companies were from all-important industrial groups like trade, finance and others, and were scattered all over the country, i.e., a fairly representative study. The study was mainly divided into two parts. First part investigates the need felt by corporate managers for inflation accounting and the second part deals with a study of the inflation accounting practices adopted by some of the responding companies. Only nine of the responding eighty companies were using some method to adjust their accounts for inflation, and they were all from the same industrial group. Of these, seven were from private sectors and two were from public sector. All the private sector companies considered inflation only for management accounting purposes, and none showed such information in their published annual reports. The two public sector companies, however, made adjustments for inflation in both management accounts and published accounts.

Nigam, R.S., Delhi School of Economics (1983) surveyed the Inflation Accounting in the Developing World. He noted that in the developing world, in Trinidad and Tobago, some serious efforts have been made in recent years and a high level committee (popularly named after its Chairman Mr. Joseph Punder) was set up by the Cabinet on September 22, 1977, with the following terms of reference: To investigate the effects of inflation on companies accounts and to recommend where necessary appropriate amendments to the Companies Ordinance, and to examine the effects of
inflation on tax paid by companies and other persons and where necessary to recommend
changes in the tax laws.

Parchure Rajas\(^{26}\) 1987 in his book entitled "Inflation and Accounting Theory" observed that the inflation accounting is a subject which gained widespread use in US, UK, Canada, Australia, the Latin American and the Scandinavian countries. In India too there has been a continuing discussion on this subject in which accountants, economists, industrialists and the government have participated. Despite the general agreement the need to account for inflation in preparation of financial statements, there is no agreement on the method which should be used for inflation accounting.

The book entitled "Inflation Accounting and Corporate Taxation" written by Sen T K\(^{27}\) New Delhi 1987 Studied the term ‘inflation’ came into use in the latter half of the 19th century or so but such development and of discussion remained almost confined to academics only, In around 1915 during the First World war, this term used into general. This war put an end to this stability and the wholesale price index stood double before the prices fell back to the new level of 1920’s. During the Second World War, there was a rapid increase in the prices ad wholesale prices index stood at all time high of about 160 per cent of the 1926 level.

Vernonkan\(^{28}\) in 1990 his book entitled " Accounting Theory" they discussed inflation accounting. He defined the term inflation which is usually understood by the people to mean an excessive in rise in price. In economics there is no general agreement as to its definition but it is frequently referred to as an increase in the general price level or decrease in the value of money or an increase in the value of national
income greater than the increase in its real income. The common characteristics appear to be relationship between money on the one hand and goods and services in general on the other. Therefore, it is safe to say that the inflation pertains to increase in the general level of prices. Inflation can only be measured indirectly through a general price index.

Gupta, R. L., and Radhaswamy, M (1991) in his book entitled 'Financial Accounting' explain inflation accounting the recording of business transaction under the assumption that monetary unit is stable as known as historical cost approach (HCA). Under historical cost accounting assets of recorded by business at the price at which they are acquired and their will be no changing their values even if the market values of such assets change. Under this method no recognition is given to change in the value of money as a result of inflation for example if a building is purchased at Rs. 50000/- 1970 and another at Rs. 100000 in 1990, building will be shown at balance sheet at Rs.150000 without taking into account the fact that a rupee in 1970 is much more than a rupee 1990 as a consequence of the inflation. Ins such adding there is an implied assumption that the rupee of 1970 and rupee of 1990 are homogenous in value which is not correct. Therefore, building shown at Rs. 150000 serve little purpose as accounting information to the user of the balance sheet. In other hand liabilities are recorded at the amounts contracted for and such amounts are not revised to compensate for changing price level in other words cost convention is an important attribute of HCA. Assets are recorded at the cost of acquisitions ignoring the other values such as replacement cost of economic value of the assets. Most of the controversy in financial accounting center rounds this convention. The author explain the limitation of historical accounting, Concepts of
capital maintenance, profit measurement under different systems of accounting, Methods of accounting for changing price, Guidance note issued by the Institute of Chartered Accountants of India in respect of accounting for changing prices

The book entitled “Accounting Theory and Practice” edited by Surgan C Jain N. D. Mathur in 1994 (Arihant Publishing House) Jaipur. They edited 18 articles of celebrated authors in various areas like Material Management, return on investment etc. One of them is the Inflation Accounting in India—Perception of Chartered Accountants written by Subhash Chandra and J.S. Arora. They studied that historical is the basis of traditional accounting and historical cost accounts is based on the 'cost or objectivity concept'. It is assumed under this concept that every transaction must be supported by facts and material evidence. The unique property of historical cost is that it is based on recording of events which have actually occurred rather than upon contingent events. The financial statements are prepared by cost management and financial accountant have generally enjoyed a high rate of confidence and credibility among the internal as well as external users. The financial statements are still prepared on the basis of historical cost system which has lost its efficiency in view of the significant reduction in the purchasing power of money. Conventional historical accounts are presenting misleading view both the companies results and its value. Sen Gupta (1976) conducted a study on “Inflation Accounting in India”. The study highlighted the problem of the measurement of price changes through price indices and suggested a combined method of current purchasing power accounting (CPPA) and CVA for use. Ram Narain & Nigam (1978) in his study of “Valuation of Corporate Property and Inflation Accounting” focused on the evolution of
suitable modification of financial statements, accounting methods and development of management information system so that financial documents reflect a realistic model of the physical situation. The Federation of India Chambers of Commerce and Industry (FICCI) organised a workshop on 'Inflation Accounting' in Bombay in 1979. The Indian Institute of Management (I.I.M) Ahmedabad published a monograph on 'Inflation Accounting Practices in India' in 1980. N. Mishra (1982) in his work “Accounting for Price-Level changes” highlighted the nature of the problem encountered in times of inflation and the measures suggested for the purpose. The study was undertaken with a view to measure the effects of price level changes on financial statements of four selected companies by applying general purchasing power accounting (GPPA) method. Institute of Chartered Accountant of India (1982) issued a discussion paper on "Treatment of Changing Prices in Financial Statements" and favoured current cost accounting method of price level accounting as it seems to be most appropriate in the context of economic environment in India. Kamal Gupta (1982) attempted to review the accounting practices by companies in India and the impact of such accounting practices in profit and value measurements of these companies. He also attempted to study the relative feasibility of adopting the major proposal regarding accounting for price changes under Indian conditions. Ramesh Gupta (1983) in his work titled "Inflation Accounting" provided self contained explanation of inflation accounting and suggested three methods to be followed depending on the objectives to be served viz., current purchasing power, current cost accounting and SGPLA (Specific and General Price Level Accounting) which combines current purchasing power and current cost accounting. G.C. Meheshwari (1983) in his
work on measurement of business income suggested the need for further experimentation as there is not yet a general consensus in favour of a particular approach aimed at explaining the effects of changing price. Porwal and Mishra (1985) in Macro Study on "Inflation Accounting in a Developing Economy" focussed on the magnitude of inflation and distortions created by it the corporate practices, the viewpoint of external users and a case study for a system of accounting which automatically takes care of increasing / decreasing prices.

An article entitled "Accounting for Price Level Changes: Evolution Perspective and Prospectus" by Ashit. B. Saha in 1995. In this paper the another gives a brief review of the evolution of the Accounting for Price Level Changes (APC) in certain countries of the world, more particularly the status of APC in the U.K., the USA. The author also highlights the concern of academic community as well as of the accounting bodies as to the desirability of introducing APC, although the matter is still subject to controversy.

Shukla, M.C., Grewal, T.S., and Gupta, S.C. in his book entitled "Advanced Accounts" in 1997 explain, due to inflation, the matching principle, vital to preparation of proper financial statements, is violated. If sales are entered in profit and loss account in terms of 1988 rupee, it is but proper that the relevant costs should also be in terms of 1988 rupee. That obviously is not so in the case of depreciation, but will the matching principle be satisfied if the goods sold were purchased say in 1986? To satisfy this principle, it will be necessary to restate the 1986 purchases in terms of 1988 prices. It is now generally agreed that there is an imperative need for inflation-adjusted financial
statements to be prepared and presented to the shareholders and other interested parties. This is because the phenomenon of inflation is widespread and also has continued for a long time now; as a result, financial statements prepared on his historical cost basis do not, as a rule, portray the real state of affairs neither the results of operations nor the financial position. However historical cost financial statements will continue to be presented, only they will be supplemented by U.K. and the U.S.A. In U.K. the position has been formalized by the Institute of Chartered Accountants in England and Wales through SSAP-16 and in U.S.A. the Securities and Exchange Commission has framed regulations to require supplementary inflation adjusted accounting statement. SEC permits the use of the current purchasing power method called. "Constant Dollar Method" as well as the current cost accounting method. In India the position is that there is no compulsion as yet for any company to present accounts otherwise than on the basis of historical costs. Some companies have revalued their fixed assets but the purpose in their cases appears to be quite different from that of inflation accounting since even the reported profit remains largely unaffected. A few companies, on their own, have prepared supplementary financial statements on the basis of inflation but the objective seems to have been either to get a prize from the Institute of Chartered Accountants of India which Institute awards prizes annually for the best presented accounts, or to show how the real profits are lower than the reported profits and how tax and bonus to employees were unreasonably high. The author also explains the current purchasing power method and current cost accounting method and evaluation of current cost accounting.
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