CHAPTER - 3
INFLATION ACCOUNTING PRACTICES IN SOME FOREIGN COUNTRIES
CHAPTER – 3

Inflation Accounting Practices in Some Foreign Countries

Introduction

In the preceding chapter, our attempt was to examine and evaluate the approaches of inflation accounting to deal with the problem. Also a comparative study of both the approaches followed by different enterprises to tackle the inflation was made. The present chapter is primarily devoted to a study of the inflation accounting practice in foreign countries. This chapter will throw light on the inflation accounting in some foreign countries viz., United State of America, United Kingdom, Canada, France, Belgium, Sweden, Japan, Germany, Australia and Italy. A recent survey of inflation accounting practices in other countries has indicated that attempts to mitigate the distorting effects of inflation on financial statements are found in many forms and in many countries. The surveys are permitted in a large number of countries besides the United Kingdom. In certain countries such revaluations have been made compulsory at certain times, and in some South American countries annual revaluations of assets have been required by the authorities for some years. This has been the case, for example in Brazil since 1964, in Chile since 1963 and in Argentina since 1972.

A wide variety of more or less sophisticated methods of assets revaluation have been adopted in different countries. In some, all companies use a single wide-ranging index, usually a consumer price index or wide-ranging index of wholesale prices. Most South American countries use such a method because it is simple and easy to administer
in a rapidly developing country. However, other countries permit more precise methods of valuation to be used, based on individual estimates of value or specific indices. This is the present position in the United Kingdom. In the United States of America revaluations of assets are not permitted in the basic accounts, but few other countries maintain this strict historic cost position.

The ultimate approach to the problem as we know is asset write-up. In varying degree, this has been required by the governments of Italy and Japan. Increased depreciation based on write-up is permitted in these countries, and also in Belgium, France\(^3\), Germany permits write-up but no additional depreciation may be deducted. Further, even though their governments neither prescribe write-up, nor permit additional depreciation on the increased base, there is a fairly widespread practice of upward revisions of assets in Australia, Canada and Great Britain.

Of those assets adjusted, the majority are fixed assets, although in some cases almost all assets were restated. The example of restatements in different countries are being given in this chapter. The amount of the revaluation has been determined in some cases by appraisals, in others by the use of statutory price level coefficients setting an upper limit on a reasonable value, considering such factors as replacement cost, use, capacity and earning power.

The results created, as a result of asset write-up has in some cases remained free of tax. Japan has taxed revaluation surplus and Germany levied a tax on revalued net worth. Only the amount of revaluation surplus subsequently capitalized is taxed in France and Belgium.
The Belgium, incidentally, have been something of pioneers in this price level area. As early as 1936, their government attempted to give relief from taxation of price level gains on the sale of capital assets. It issued a table of coefficients by years, these to be applied to the cost of capital assets, in accordance with the year of purchase. Depreciation previously allowed was to be deducted from the revaluation asset, and only the excess of the proceeds over this next value taxed as gain.

While it may considered only a partial answer to the price level problem, more acceleration of the process of depreciation accounting based on cost has a tendency to overcome some of the distortions. Initial depreciation (where an abnormally large amount is permitted to be deducted in the year of acquisition), accelerated rate depreciation and declining balance are employed in many areas. This latter method is government endorsed and is in general use in U.K., despite the recommendation of the Institute of Chartered Accountants in England and Wales that straight line be used exclusively. In Germany and Sweden, the tax authorities permit immediate write-off of fixed assets if they are used a certain amount or have a life of less than two or three years.

In the U.S.A. the use of LIFO as a modified inflation-correcting device is quite familiar. Other countries whose tax laws permit the use of LIFO are Canada, Italy, and Japan. Base stock, used sparingly are, is used widely in Sweden, recommended by professional accountants in Japan (although not permitted there for tax purposes), and is permitted in modified form in France and Italy.

A number of techniques are used in the area of establishing reserves, some merely surplus appropriations and other actually used in the determination of net income. The
former are most prevalent in Australia, Canada and U.K. the setting up replacement or price fluctuation reserves, as a charge to income has been utilized both as a tax deduction and without tax effect in France, Germany and Italy.

Several other approaches might be classed as economic expedients rather than corrective accounting devices. Over and above the usual depreciation deductions, in the U.K permits additional tax deductions for a certain percentage of capital investments. A more controlled form of this reserve approach is permitted in Sweden.

A rather drastic means of avoiding the over staging affects of inflation on profit is the deliberate understatement of income, i.e., the creation of secret reserves. Oddly enough, this practice is even condoned by some governments, and is prevalent in Australia and Sweden. In recent years, however, the Swedish government has deemed it necessary to limit some of its earlier liberalities.4

The United States of America

In USA, the accounting principle Board (APB) of the American Institute of certified public accountant (AICPA) and its predecessor, the committee on accounting producer under took extensive studies on the subject of inflation accounting as early as 1947.5 In the late 1960’s and early seventies the professional accounting bodies favoured a method of constant purchasing power accounting similar to the one proposed by Sweeney in 1936 in his book Stablished Accounting. Later on, a major study on the subject published in 1963 by AICPA under the title, “Reporting The Financial Effects of Price level Changes”.6 Another important landmark in the development of General Purchasing Power Accounting method was the publication by the Accounting Principles Board
(APB) which issued statement No. 3, in June 1969 of "Financial Statements Restated for General Price-level changes". This statement is recommended that historical dollar financial statement be supplemented by general price level information. But this recommendation of accounting principles board that companies should adopted the general purchasing power method has hardly been taken up by any U.S. companies.  

The sole convention in the direction of accounting for price level changes has been the rather widespread adoption of LIFO method, which provides and which one suspects, has been adopted more for its tax advantage than for more accurate disclosure of financial performance. However, where stock volumes are not recorded, the LIFO convention leads to the exclusion of stock appreciation from profit and to that extent is in line with the principles of current cost accounting, as recommended by Sandilands Committee in U.K.

Later, in December 1974, the Financial Accounting Board (FASB), a successor to the Accounting Principles Board issued a proposed statement entitled "Financial Reporting in Units of General Purchasing Power" which would have required reporting of certain information from general price level adjusted statements beginning on or after the January 1, 1976 fiscal year.

In late 1975 while FASB was studying the comments it had received on the proposed statement, the Securities and Exchange Commission (SEC) which had also been studying the problem of inflation accounting for sometime, decided to issue Accounting Series Release No. 190 (ASR 190), "Notice of Adoption of Amendments to Regulation S-X Requiring Disclosure of Certain Replacement Cost Data".
In March 1976, the U.S.A. probably being the most advanced industrial country currently least concerned about inflation became first to require its major manufacturing companies, by law, to include in their accounts an indication of the impact of inflation on their operations. The decision was taken by the Securities Exchange Commission (SEC). The SEC's action has been taken the form of amendments to its corporate disclosure regulations and requires companies to add to their 1976 balance sheet; to be published in early 1977, footnotes setting out the impact of inflation on specific balance sheet items.

In arriving at what form of inflation accounting to adopt, the Securities Exchange Commission has taken up a position similar to, but far less sweeping than that adopted by the Inflation Accounting Committee in U.K. (Sandilands Committee). It has taken the view that replacement cost accounting is the most appropriate adjustment to inflation. In doing so it has rejected the position which the U.S. financial Accounting Standard Board appeared to be moving towards. The FASB has published discussion proposals on current purchasing power accounting, under which inflation is corrected by applying price index criteria.

The new regulations require that companies with inventories, property, plant and equipment valued at $100 million and accounting for over 10 per cent of gross assets must include in their accounts footnotes containing inflation adjustments. The footnotes must disclose the estimated replacement costs of inventories (that is stock) and productive capacity at the end of each fiscal year, for which a balance sheet is required. They must also disclose the approximate amount of cost of sales depreciation based on replacement cost for the two most recent full fiscal years. The companies are further
required to disclose the method for calculating these replacement cost figures. But the information may be presented either as a footnote to the financial statements or in a separate section of accounts and in either case, it is to be shown as “unaudited”.

Thus whereas Sandilands Committee envisages sweeping away the traditional historic cost accounting, the Securities Exchange Commission is only requiring the major corporations to include what it concedes may be subjective estimates of the impact of replacement cost accounting in unaudited footnotes. The SEC’s new regulations provide that companies may show the replacement cost data in terms of ranges rather than single figures and discuss the imprecise nature of the new data, indicate their plans for replacement or non-replacement of assets and indicate, for example, the likely impact of changing technology on their cost structure.

Currently, however, business seems to have taken the view that it might as well as bow to the inevitable and there is little sign of the earlier controversy reviving. In part this reflects the fact that inflation in the U.S. is now thought to be running at only 6 per cent, and therefore, the impact of the replacement cost footnotes on accounts is likely to be less significant than it would have been a year ago. The implications for inflation-adjusted profits are also less serious now that corporate earnings are recovering sharply from last year’s serious setbacks.

Thus whereas currently conceptually, there were considerable difference between the current cost of fixed assets under the current cost accounting method recommended in the UK by the Sandilands report at that time and the Securities Exchange Commission replacement cost of the equivalent capacity of fixed assets. The Sandilands method deals
with the fixed assets a company actually owns, and the current cost normally would be their replacement cost. The Securities Exchange Commission is concerned with replacement cost of the equivalent productive capacity of the fixed assets. The difference in the two approaches still persists and to select one for its appropriateness is still a difficult task.

On March 31, 1977, many of the United States' largest public companies fields with the Securities and Exchange Commission their first annual replacement cost-rule. In a study made by Arthur Young (a prominent CPA firm in the USA), summarising the result of 175 companies which disclosed the data by the time of study, the current cost of replacing gross productive capacity was, on average, about two times the original cost, net productive capacity was from two-thirds to three-fourths higher on a replacement cost basis; and current cost depreciation expense. However, the degree to which replacement costs exceeded historical costs varies widely among the companies included in the study. The ratio of replacement cost to the historical cost of inventories varied significantly, depending on whether the FIFO or LIFO method was used in preparing financial statements and whether additional replacement cost depreciation was included in estimating the replacement cost of inventories.

The Securities Exchange Commission rule did not require disclosure of net earning adjustments (and in fact does not provide all the necessary data to make this conversion), but a study of 30 Dow Jones industrial companies done by T. Rowe Price Associates showed that on an average pretax profit margin has declined from 8.9 per cent to 5.9 per cent, price/earnings multiple has increased from 10.3 to 33.7 and the dividend
pay out ratio increased to 144.9 per cent from 44.3 per cent. According to their summary, 7 out of 30 companies would find their earnings converted to net losses. US Steel, one of the hardest hit companies, would find its stock selling at a price / earnings multiple of 93 and would effectively be paying dividends amounting to 3.96 times its earnings.

The business community did not receive ASR 190 well. There were both conceptual and practical problems. Business Week’s characterisation of ASR No. 190 as a “curious dream world” probably captured the gist of arguments put against the proposal. Continent Oil in its report to Securities Exchange Commission stated that “it is the opinion of management that these data are of limited, if any, value because of the substantial conceptual difficulties and the imprecision inherent in the estimation process”. Similarly, General Motors considered replacement cost data as “of no value because of the subjectivity involved in making these estimates, and because the concept is based on an unrealistic premise, i.e., the total replacement of all productive capacity at one time. Accordingly, these data must be viewed as simply the result of the mathematical calculations based on the guidelines established by SEC.

The SEC did not require the companies to disclose replacement cost information in annual reports to shareholders as long as they provided their shareholders with a generalised description of the impact of inflation and referred them to the information contained in Form 10-K of the report. According to Arthur Young’s study, nearly 80 per cent of the companies just did that, 10 percent took a partial disclosure approach, less than 10 per cent included their full 10-K disclosure in shareholders reports, while a few
merely referred readers to the Form 10-K report without discussing the impact of inflation.

ASR 190, when issued for the first time in 1976 was experimental in its nature, but SEC decided to continue with its replacement cost disclosure rule for the time being. FASB’s proposed statement issued in 1974 also could not get off the ground. The need remained to explore in a meaningful way the various methods whereby business could report the effects of inflation on their results of operations. To assist the FASB in the effort to develop a “Conceptual Framework of Accounting and Reporting” AICPA constituted a task force to study the various proposals of concept and measurement. Four accounting models were developed from various alternative conducted to ascertain their suitability. The four models were:

i. A “simplified” general price level adjusted historical cost approach
ii. A “modified” historical cost approach requiring LIFO inventory valuation and indexed current cost depreciation
iii. A hybrid current-cost current value approach
iv. A comprehensive current value approach.

Approximately 25 companies participated in the AICPA task force’s experimentation programme by applying each of the four inflation accounting models to their own situation for two consecutive fiscal years.

After considering the participants’ responses, FASB issued, in 28th December 1978, an Exposure Draft entitled “Financial Reporting and Changing Prices’ followed by the issuance on 2nd March 1979 of another Exposure Draft; Constant Dollar Accounting
as a supplement to the 1974 proposed statement on general purchasing power adjustments. These two exposure draft would require large, publicly held companies to present supplemental information on the current year income from continuing operations and a five year summary of key data. Companies would have to choose between the current cost basis and the historical cost / constant dollar basis price level accounting. The exposure period of these two exposure drafts ended on 1st May 1979 and in September 1979 the FASB issued Statement of Financial Accounting Standard (FAS) No. 33: Financial Reporting and Changing Prices.

The objectives of FAS-33 recognise that information about the effects of changing prices should be available to investors, creditors, and others involved in resource allocation decisions including those in government policy making. The information is intended to help in assessing future cash flows, evaluating enterprise performance and operating capability, and judging erosion of general purchasing power.11

The major accounting requirements of the Standard are briefly summarised as under:

i. The Statement requires disclosure of both the constant dollar information (arising out of changes in the general price-level) as well as the current cost information (arising out of changes in specific prices).

ii. The index recommended to compute constant dollar information is the Consumer Price Index for All Urban Consumers, published by the Bureau of Labour Statistics of the U.S. Department of Labour, and the index numbers of prices of specific assets for current cost accounting. Constant dollar accounting is defined
by the statement as a method of reporting financial statement elements in dollars, each of which has the same (i.e., constant) general purchasing power. Current cost accounting is a method of measuring and reporting assets and expenses associated with the user or sale of assets at their current cost or lower recoverable amount at the balance sheet date or at the date of use or sale.

iii. No changes are to be made in the primary financial statements. The information required by the statement is to be presented as supplementary information in published annual reports, and may be presented as a supplementary statement or by way of schedules or supplementary notes in financial reports outside the basic financial statements.

iv. The enterprises are required to report.  
(a). Income from continuing operations adjusted for the effects of general inflation.
(b). The purchasing power gain or loss on net monetary items.

The enterprise are also required to report:
(a). Income from continuing operations on a current cost basis.
(b). The current cost amounts of inventory and property, plant, and equipment at the end of the fiscal year.
(c). Increase or decrease in current cost amounts of inventory and property, plant, and equipment, net of inflation.
(v). The Statement requires enterprises to present a five year summary of selected financial data, including information on income, sales and other operating revenues, net sales, dividends per common share, and market price per share. In
the computation of net assets, only inventory and property, plant and equipment
need be adjusted for the effects of changing prices.
The statement applies to the US and foreign public companies whose equity securities or
debt trade on any of the US Stock Exchange and whose historical cost accounts shows
inventories and fixed assets exceeding $125 million or total assets after deducting
accumulated depreciation exceeding $1 billion.
The provisions of the statement became effective fiscal year beginning on or after
December 25, 1979. The implementation of the provisions relating to the presentation of
current cost information could be deferred by one year if a company desired so.
If we compare the proposals of FASB-33 with the earlier proposals for general
price level accounting particularly the FASB's 1974 Exposure Draft we would note that
FASB-33 differs from those proposals in some important aspects. Some of differences
are:
1. Change in purchasing power is measured by consumer price index (urban CPI –
U) instead of gross national product implicit price deflator.
2. Unless restatement is comprehensive, restatement is to be in terms of average
purchasing power of the dollar during the current year. In the earlier proposals, the
restatement was to be done in terms of the purchasing power of the end-of-the year
dollars.
3. Under FASB-33 restatement need not be comprehensive. It allows companies to
restate only specified financial statement items.
4. **Purchasing power gain or loss on net monetary items is excluded from income from continuing operations.**

5. **Under certain circumstances, a company may use depreciation methods and estimates of useful lives and salvage values different from the method and assumptions used in historic cost financial statements.**

6. **If assets recoverable amounts are judged to be “materially and permanently lower” than the restated historical cost in constant dollar amounts, then assets shall be restated at their recoverable amount. Evaluations of the recoverable amount from the assets held for sale would be net realisable value and for assets not held for sale would be the present value of future net cash flow expected to be derived from using assets in the normal course of the business. Unlike realisable value it recognises the time value of money.**

Although by no means perfect, FASB has provided opportunities for American business with ways of measuring performance in an inflationary environment. Robert Sprouse, the then FASB Vice Chairman called FASB-33 as “the important standard ever issued by the board or likely to be issued for sometime”. Until very recently SFAS-33 was emerging as the current APC standard in the USA but in December 1986 another standard was issued entitled SFAS – 89 by the FASB which emerges as the latest APC standard in the USA.

Finally, the current status of inflation accounting in U.S.A. has been spelt out in SFAS No. 89 issued by the FASB in December 1986 in the following words: “This Statement supersedes SFAS No. 33 (and its subsequent amendments, viz. 39, 40, 41, 46,
54, 69, 70, and 82). A business enterprise that prepares its financial statements in U.S. dollars and in accordance with the GAAP, is encouraged but not required to disclose supplementary information on the effects of changing prices”.

It is, however, clear enough from the language of the FASB and SFAS-89 is not mandatory but optional in nature as regards its applicability to those companies which prepare their financial statements in U.S. dollars and in accordance with the U.S. GAAP. Such companies are only encouraged but not required for furnish supplementary information on the effects of changing prices.

According to SFAS-89 the business enterprises preparing financial statements in U.S. dollar and in accordance with the U.S. GAAP are encouraged (not required) to give supplementary information of the effects of changing prices on the following items:

i. Net sales and other operating revenues.

ii. Income from continuing operations on current cost basis.

iii. Purchasing power gain or loss on monetary items.

iv. Increase / decrease in the current cost or lower recoverable amount of inventory and property, plant and equipment, net of inflation.

v. The aggregate foreign currency translation adjustments on a current cost basis wherever found applicable.

vi. Net assets at year-end of current cost basis.

vii. Income per common share from continuing operations on current cost basis.

viii. Market price per common share at year-end.
It is observed that both constant dollar and current cost data required to be disclosed in U.S., which generates confusions in the minds of users of financial statements. This dual disclosure standard of accounting for price level changes also leads to serious criticisms of accounting for price level changes in the country. According to the critics, out of the three options, viz., (i) disclosure of constant dollar or current cost data but not both, (ii) disclosure of current cost data only and (iii) disclosure of constant dollar data only, any one has to be adopted to avoid confusion. The first alternative would have companies with significant amount of inventory and fixed assets continue to disclose current cost data whereas other would disclose constant dollar data. It is suggested this approach would not impair the comparability of the current cost disclosures because companies with material amount of inventory and fixed assets would continue to report current cost data, for other companies the current cost and constant dollar disclosures required by Statement on Financial Accounting standards (SFAS)-89 are not significantly different. The second alternative would require current cost disclosure for companies with significant amount of inventory and fixed assets and exempt the other companies from disclosure requirements. The third alternative would require the companies to disclose only constant dollar data, which are less costly to prepare and easy to verify.

During the past few years the following companies in the United States have either completely or partially adjusted their financial statements for changes in the general price level. These companies used broad-based price-index for some items.
Reece Corporation, U.S.A: This Company has for a number of years completely adjusted its financial statements for internal purposes to reflect price level changes and has presented certain significant adjusted items in the annual report.

Indiana Telephone Corporation: This corporation presents complete supplementary financial statements with fixed assets and depreciation charges adjusted on the basis of a debited current cost study by a registered Professional Engineer.

Hercules Powder Company: This company presents three adjusted items including net income.

Eastman Kodak Company: This company presents its sales in "Constant Dollars".

Ayrshire Colleries Corporation: This corporation adjusts depreciation only.

Reece Corporation: The Reece Corporation was one of the four companies included in the American Accounting Association study conducted by Ralph C. Jones. Ever since the completion of the study, the Reece Corporation has included in its annual report a special section in which comments and charts have kept the reader up to date as to the effect of price level changes upon certain selected phases of its operations. As far as I know, this is the only case where presentations have been based upon completely adjusted financial statements. It should be noted that net income figures do not include gains and losses on monetary items since, under the method adopted in the original study, these gains and losses were show in an analysis of the changes in the stockholders' equity rather than in the income statement.

To illustrate the detailed procedure involved in the practical application of constant dollar method used in U.S.A., we have given a full worked example, which is
based on the Financial Statement of Hartley Company. Assume the company starts business on December 31, 1997 by selling $190,000 of capital stock for cash. Land costing $80,000 is purchased immediately. During 1998, the company reports $190,000 of sales, cost of goods sold of $100,000, and operating expenses of $20,000. The income statement for Hartley Company on a historical cost basis is given in table – I.

**Table – I**

**Hartley Company**

INCOME STATEMENT (HISTORICAL COST)

For the Year Ended December 31, 1998

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$190,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>$100,000</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>$90,000</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>$20,000</td>
</tr>
<tr>
<td>Net Income</td>
<td>$70,000</td>
</tr>
</tbody>
</table>

The comparative balance sheet on a historical cost basis are given in table II

**Table- II**

**Hartley Company**

BALANCE SHEET (HISTORICAL COST)

As on December 31

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$145,000</td>
<td>$110,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>35,000</td>
<td>-</td>
</tr>
<tr>
<td>Land</td>
<td>$80,000</td>
<td>$80,000</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$260,000</td>
<td>$190,000</td>
</tr>
</tbody>
</table>


Liabilities and Stockholders’ Equity

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Stock</td>
<td>$190,000</td>
<td>$190,000</td>
</tr>
<tr>
<td>Retained earning</td>
<td>70,000</td>
<td></td>
</tr>
<tr>
<td>Total liabilities and stockholders’ equity</td>
<td>$260,000</td>
<td>$190,000</td>
</tr>
</tbody>
</table>

The relevant price index for use in preparing constant dollar financial statements are presented in table- III. These price indexes are magnified here to illustrate their effect.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Table-III</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Price Indexes</strong></td>
<td></td>
</tr>
<tr>
<td>December 31, 1987</td>
<td>100</td>
</tr>
<tr>
<td>1998 average</td>
<td>160</td>
</tr>
<tr>
<td>December 31, 1998</td>
<td>200</td>
</tr>
</tbody>
</table>

**Constant Dollar Income Statement:** When a constant dollar income statement is prepared revenues and expenses are restated to end-of-year dollars. The difference between restated revenues and expenses reported as income (loss) before purchasing power gain (loss). The purchasing power gain (loss) is then added (deducted) to produce “constant dollar net income (loss).” Revenues and expenses are usually assumed to occur evenly throughout the period. Therefore, the historical dollar amounts are multiplied by the restatement ratio, of which the numerator is the end-of-year index and the denominator is the average index. The constant dollar income statement for Hartley Company is shown in table – IV.
### Table IV

**Hartley Company**  
CONSTANT DOLLAR INCOME STATEMENT  
For the Year Ended December 31, 1998

<table>
<thead>
<tr>
<th>Item</th>
<th>Value</th>
<th>Restated Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$237,500</td>
<td>($190,000 x 200/160)</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>125,000</td>
<td>($100,000 x 200/160)</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>112,500</td>
<td></td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>25,000</td>
<td>($20,000 x 200/160)</td>
</tr>
<tr>
<td>Income before purchasing power loss</td>
<td>87,000</td>
<td></td>
</tr>
<tr>
<td>Purchasing power loss</td>
<td>(118,750)</td>
<td></td>
</tr>
<tr>
<td>Constant dollar net loss</td>
<td>($31,250)</td>
<td></td>
</tr>
</tbody>
</table>

Restatement of the items shown in table IV is explained as follows:

**Sales:** Because sales were spread evenly over the year, the average index is used in the computation to restate sales to end-of-year dollars.

**Cost of Goods Sold:** The cost of goods sold of $100,000 consists of two amounts, purchases of $135,000 less ending inventory of $35,000. Because the costs of purchases and ending inventories were spread evenly over the year, the average index is used in the computation to restate cost of goods sold to end-of-year dollar.

**Operating Expenses:** Because operating expenses were spread evenly over the year, the average index is used in the computation to restate operating expenses to end-of-year dollars.
**Purchasing Power Loss:** Computation of the purchasing power gain (loss) on monetary items requires a reconciliation of the beginning and ending balances of each monetary item for the period. A restatement ratio is then applied to the beginning balance and each reconciling amount. Hartley Company has only one monetary item, cash. Because prices are rising, it will experience a purchasing power loss for 1998. The computation of the loss is shown in table -V.

**Table-V**

**COMPUTATION OF PURCHASING POWER LOSS**

<table>
<thead>
<tr>
<th>1998 Historical x Ratio = to 12/31/98 Dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash:</td>
</tr>
<tr>
<td>Beginning balance $110,000 200 100 $220,000</td>
</tr>
<tr>
<td>Add: Sales 190,000 200 160 237,000</td>
</tr>
<tr>
<td>Deduct: Purchases (135,000) 200 160 (168,750)</td>
</tr>
<tr>
<td>Operating Expenses (20,000) 200 160 (25,000)</td>
</tr>
<tr>
<td>Total Restated Dollars $145,000 263,750</td>
</tr>
<tr>
<td>Ending Balance $145,000 145,000</td>
</tr>
<tr>
<td>Purchasing Power loss $(118,750)</td>
</tr>
</tbody>
</table>

The first column of table-V provides a reconciliation of the beginning and ending cash balance. Note that purchase is determined by adding ending inventory ($35,000) to cost of goods sold ($100,000) for Hartley Company. The restatement ratio for the beginning
Cash balance is based on the price index at the beginning of the year (100). The other ratios are based on the average price index during the year (160). The total restated dollars, $263,750, indicates how much cash the company should have in order to stay even with the price increases that have occurred. This amount is then compared with the historical cost ending balance to determine the amount of the purchasing power gain or loss. In this case, Hartley should have $263,750; it has only $145,000. Therefore, it has experienced a purchasing power loss of $118,750.

**Constant Dollar Balance Sheet:** When a constant dollar balance sheet is prepared, all monetary items are stated in end-of-year dollars and therefore do not need adjustment. Non-monetary items, however, must be restated to end-of-year dollars. The constant dollar balance sheet for Hartley Company is shown below in table -VI.

**Table –VI**

<table>
<thead>
<tr>
<th>Hartley Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>CONSTANT DOLLAR BALANCE SHEET</td>
</tr>
<tr>
<td>December 31, 1998</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Assets</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$145,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>43,750</td>
</tr>
<tr>
<td>Land</td>
<td>160,000</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$384,000</td>
</tr>
</tbody>
</table>
Liabilities and Stockholders' Equity

Capital Stock $380,000 ($190,000 x 200)

Retained earnings (31,250) (See constant dollar income statement)

Total liabilities and Stockholders' equity $384,750

Restatement of the items shown in table - VI is explained as follows:

Cash. Cash is a monetary item; therefore, no restatement is necessary.

Inventory. Inventory is a non-monetary item and therefore it must be restated. Because inventory was purchased evenly throughout the year, the $35,000 must be multiplied by the ratio of the ending index, 200, to the index at the time the inventory was purchased, which was the average for the year of 160.

Land. Land is a non-monetary item; therefore, it must be restated. Because land was purchased at the end of the preceding year, the $80,000 must be multiplied by the ratio of the ending index to the index at the time the land was purchased, which was 100.

Capital Stock. Capital stock is a non-monetary item; therefore, restatement is necessary. Because capital stock was issued at the end of the preceding year, the $190,000 must be multiplied by the ratio of the ending index, 200, to the index at the time the capital stock was issued, which was 100.

Retained Earnings. Since no balance existed in retained earnings at the beginning of the year, the retained earnings in constant dollars, includes only the constant dollar net loss.
for the current period of $31,250. Thus, Hartley Company on a constant dollar basis reports negative retained earnings after its first year of operations.

Like constant dollar method the companies in U.S.A. in preparation of financial statements also issue current cost accounting method. To illustrate the preparation of financial statements on the current cost basis, we have given a full worked example of Sensor Insurance Co. Assume the company starts business on December 31, 1997, by selling $90,000 of capital stock for cash Land costing $40,000 is purchased immediately. During the next year, the company reports $160,000 of sales revenue, cost of goods sold of $75,000, and operating expenses of $25,000. The income statement for Sensor, Inc., on a historical cost basis is given in table – VII.

Table – VII

Sensor Insurance Company
INCOME STATEMENT (HISTORICAL COST)
For the Year Ended December 31, 1998

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$160,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>75,000</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>85,000</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>25,000</td>
</tr>
<tr>
<td>Net Income</td>
<td>$60,000</td>
</tr>
</tbody>
</table>

The comparative balance sheet on a historical cost basis are given in table-VIII.
Table VIII
Sensor Insurance Company
BALANCE SHEET (HISTORICAL COST)
December 31

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$30,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>80,000</td>
<td>-</td>
</tr>
<tr>
<td>Land</td>
<td>40,000</td>
<td>40,000</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>$150,000</strong></td>
<td><strong>$90,000</strong></td>
</tr>
</tbody>
</table>

|             |          |          |
| **Liabilities and Stockholders’ Equity** |          |          |
| Capital Stock | $90,000  | $90,000  |
| Retained earning | 60,000   | -        |
| **Total liabilities and stockholders’ equity** | **$150,000** | **$90,000** |

The relevant current cost amounts for the income statement and balance sheet items for 1998 are given in table IX.

Table IX
Relevant Current Cost Amounts

<table>
<thead>
<tr>
<th></th>
<th>Income Statement</th>
<th>Balance Sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$160,000</td>
<td>Cash</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$30,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>95,000</td>
<td>Inventory</td>
</tr>
<tr>
<td></td>
<td></td>
<td>150,000</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>25,000</td>
<td>Land</td>
</tr>
<tr>
<td></td>
<td></td>
<td>48,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Capital</td>
</tr>
<tr>
<td></td>
<td></td>
<td>90,000</td>
</tr>
</tbody>
</table>

Current Cost Income Statement: In a current cost income statement, two income numbers are reported. The first, current cost income from operations is sales revenues less current
cost of goods sold plus operating expenses. This amount is the income a company has earned after providing for the replacement of assets used in operations.

The second income number, current cost net income, measures the total income of a company from one period to the next. Thus, holding gains (losses) are added (deducted) to current cost income from operations to arrive at this number. The current cost income statement for Sensor, Inc. is given in table-X.

**Table -X**

Sensor Insurance Company

**INCOME STATEMENT (CURRENT COST)**

For the Year Ended December 31, 1998

<table>
<thead>
<tr>
<th>Activity</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$160,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>95,000</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>65,000</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>25,000</td>
</tr>
<tr>
<td>Current cost income from operations</td>
<td>40,000</td>
</tr>
<tr>
<td>Holding gain</td>
<td>53,000</td>
</tr>
<tr>
<td>Current cost net income</td>
<td>$93,000</td>
</tr>
</tbody>
</table>

The preceding items shown table – X is explained as follows:

**Sales and Operating Expenses:** Sales and operating expenses are already stated at their current cost amounts on historical cost statements; therefore, no adjustment is needed for these items.

**Cost of Goods Sold:** Goods are sold at varying times of the year. At the time these goods are sold, the current cost of the inventory sold must be determined. The historical cost goods sold and the current cost of goods sold are usually different.
Total Holding Gain. The holding gain for Sensor comprises three items as shown in a table -XI.

<table>
<thead>
<tr>
<th>Item</th>
<th>Current Cost</th>
<th>Historical Cost</th>
<th>Holding Gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current cost of goods sold</td>
<td>$95,000</td>
<td>$75,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Historical cost of goods sold</td>
<td>$105,000</td>
<td>$80,000</td>
<td>$25,000</td>
</tr>
<tr>
<td>Current cost of inventory</td>
<td>$48,000</td>
<td>$40,000</td>
<td>$8,000</td>
</tr>
<tr>
<td>Historical cost of land</td>
<td>$53,000</td>
<td>$53,000</td>
<td>$53,000</td>
</tr>
</tbody>
</table>

Recall that a holding gain is an increase in an item’s value one period to the next. If the item is sold during the period, however, the holding gain (loss) is computed only to the point of sale. Thus, the inventory sold, as reported in the current cost of goods sold amount, had increased $20,000. Also, inventory on hand and land experienced holding gains of $25,000 and $8,000, respectively. Holding gains or losses indicate how effective management is in acquiring and holding assets.

Current Cost Balance Sheet: The preparation of a current cost balance sheet as relatively straightforward. Monetary items are not adjusted because they are already stated at current cost. Similarly, capital stock equity is not adjusted because its balance represents the current cost of capital stock. All other non-monetary items must be adjusted to current costs. The current cost balance sheet for Sensor, Inc. is shown in table – XII.
Table XII
Sensor Insurance Company
BALANCE SHEET (CURRENT COST)
December 3, 1998

<table>
<thead>
<tr>
<th>Assets</th>
<th>1998</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$30,000</td>
<td>(Same as historical cost)</td>
</tr>
<tr>
<td>Inventory</td>
<td>105,000</td>
<td>(Restated to current cost)</td>
</tr>
<tr>
<td>Land</td>
<td>48,000</td>
<td>(Restated to current cost)</td>
</tr>
<tr>
<td>Total Assets</td>
<td>$183,000</td>
<td></td>
</tr>
</tbody>
</table>

Liabilities and Stockholders’ Equity

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital Stock</td>
<td>$90,000</td>
<td>(Same as historical cost)</td>
</tr>
<tr>
<td>Retained earning</td>
<td>93,000</td>
<td>(From current cost Income statement)</td>
</tr>
<tr>
<td>Total liabilities and stockholders’ equity</td>
<td>$183,000</td>
<td></td>
</tr>
</tbody>
</table>

As indicated from the statement above, Retained Earnings is determined by adding the current cost net income amount to the beginning balance have retained earnings.

The United Kingdom

Having studied the significant role of inflation accounting approaches i.e., general purchasing power and current cost accounting methods in the United States America, we will now examine the importance of accounting for price level changes in the United Kingdom where the APC has only recently attracted wide attention. Though the subject has been under discussion within the professional accounting bodies for the past 45 years or so but the first formal pronouncement came in the form of Recommendation No. 12 released by the Institute of Chartered Accountant of England and Wales (ICWEA) in January 1949. This discussed the problems associated with historical cost accounting during inflation and hinted at some solutions. But it did not make any mention of the
current purchasing powering accounting method (general purchasing power accounting in U.S.A.).

The subject of inflation accounting remained at a low ebb during the next 15 years or so may be partly due to the relatively small increase in prices, though research work into the subject was continuously carried out by the accounting bodies. The subject was again rose into prominence with the rise in the rate of inflation after 1967-68. The newly formed Accounting Standards Steering Committee (ASSC) 1969 brought out a paper ‘Inflation and Accounts- Discussion Paper and Fact Sheet in 1971. The paper suggested that the companies should prepare inflation-adjusted accounts using a general index of prices and present them on supplementary basis.

Then Exposure Draft-8 “Accounting for Changes in the Purchasing Power of Money” came which was published by the Accounting Standards Steering Committee (ASSC) in January 1973. According to this draft quoted companies were required to produce general purchasing power statements on a supplementary basis using the consumer price index. Later, the Accounting Standards Steering Committee (ASSC) revised the earlier index for the conversion of accounts. Another noteworthy work under the auspices of the Institute of Chartered Accountant of England and Wales (ICWEA) was the publication of a book entitled “Accounting for Inflation: A Working Guide to the Accounting Procedures” published by the Trustees of Chartered Accountants’ Trust for Education and Research of the Institute in 1973. This book described in details some procedures required to adjust accounts for changes in the purchasing power of money.
The Accounting Standards Steering Committee (ASSC) issued ED-8 for public comment during the period up to 31 July 1973. In the meantime, the intention of the Government to set up a Committee of Enquiry on inflation accounting was announced on 25th July 1973. In view of this announcement, the Accounting Standards Steering Committee (ASSC) decided to proceed with its work to issue a Provisional Statement of Standard Accounting Practice (PSSAP) based on ED-8, taking into account the comments received on it. The Provisional SSAP-7 was issued on 14th May 1974 requiring all listed companies and others where possible, to follow it as soon as possible and preferably not later than the first accounting period beginning after 30th June 1974. The statement suggests that historical costs should be converted from an aggregation of historical pounds of many different purchasing powers into approximate figures of current purchasing power.

The main feature of the purchasing power method is the adoption of a different unit of measurement the ‘purchasing power unit in place of monetary unit’. The objective of the method is to enable accounts during a time of changing prices to be expressed in a unit of measurement which has a constant value, and is, therefore, more useful than the monetary unit. The balance sheet in fact should show the amount of ‘purchasing power’ represented by the company’s net assets rather than the amount of money; and that the profit and loss account should show the amount of ‘purchasing power’ gained or loss during the year. When compared with accounts drawn up in terms of the monetary unit, account expressed in terms of purchasing power unit would, demonstrate the affect of changes in the ‘purchasing power’ of money on a company’s affairs.
The Institute of Chartered Accountants in England are in favour of the use of the presentation using the current purchasing power method (general purchasing power method in U.S.A.) which shows the effects on annual accounts of inflation only, that is of changes in the general purchasing power of value of money. It does not show changes in values due to changes in other factors such as technology or market pressures, and, therefore, does not introduce other concepts such as replacement costs or current values. Replacement costs or current or fair value accounting concepts which can, and do, exist separately from the concept of general price level adjusted accounting, and they will continue to be discussed and developed for the particular purposes for which they are intended.

This method retains the advantages attending to the historical cost basis but also produces figures, which are reasonably comparable between companies over the course of time. Companies have for many years adjusted certain items to accord with inflationary movements, e.g. fixed assets and depreciation but it is held that this is misleading. It has, therefore, been proposed that all capital and non-monetary items should be converted in purchasing power terms. The conversion should be by means of an index of the general purchasing power of the pound, as such an index is more appropriate than indices measuring changes in specific prices, when the purpose is to changes in the value of money.

The index number to be applied in the preparation of the supplementary statement is basically that of the Retail Price Index (R.P.I) (Quality C.P.I. Dublin for the Republic of Eire). These indices are provided in the leading accounting journals. Values will have
to be interpolated where the company's financial year ends on a date other than the 31st December.

The I.C.A. have stated that in all supplementary statements, all corresponding figures should be "updated". This implies that the figures shown for the previous year should be adjusted in accordance with the purchasing power of the pound at the end of the year under review. Briefly stated, the actual methods of conversion when preparing the supplementary reports are:

1. Figures shown at the beginning of the year:
   (a) Non-Monetary Items: Adjust for changes in the purchasing power of the pound since they were acquired or revalued.
   (b) Monetary Items: Adjust for any material changes in the purchasing power of the pound since the beginning of the year.

2. Figures at the end of the year:
   (a) Non-Monetary Items: Adjust for changes in the purchasing power of the pound since they were acquired or revalued.
   (b) Monetary Items: No action required. They express the purchasing power at the end of the year.

Certain item require special treatment as in the case of stock in trade, as this has still to satisfy the test of "cost or net realisable values" and fixed assets might be reviewed in the light of the value to the business.

After SSAP-7, many statements and standards were issued on the subject till the 'Inflation Accounting Committee (1975) was appointed by the Government of U.K.
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 inflation on accounts and suggest remedial measures. The Sandilands Committee presented its report to British Parliament in September 1975 and recommended the Current Cost Accounting (CCA) as the device to reflect the affects of inflation.

The recommendations of the Sandilands Committee for the introduction of a system of Current Cost Accounting (CCA) were broadly accepted by the Government and the Consultative Committee of Accounting Bodies. In December 1976 the Inflation Accounting Steering group under the chairmanship of Mr. (later Sir) Douglas Morpheth published an Exposure Draft (Ed-18) calling for companies to produce Current Cost Accounts. The requirements were complicated and a majority of members of the English Institute of Chartered Accountants rejected them, and asked for simplification. In June 1977 the ASC published a simplified version with notes to guidance on implementation. These were produced by a committee under the chairmanship of William (Bill) Hyde. They were termed the Hyde Guidelines and were an interim measure to assist preparation of accounts on an experimental current cost accounting basis for periods ended on or after 31st December 1977 and anticipated a revised standard.

Subsequently a further Exposure Draft (ED-24) dated April 1979 added a current cost accounting balance sheet to the requirements. This was followed finally in March 1980 by the introduction of a further standard SSAP-16, which accepted the need for requirement. 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 reservations 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.\(^\text{18}\)

Firstly, it is honourable because a government appointed committee (The Sandilands Committee, 1975) in the United Kingdom had recommended the use of this accounting technique to overcome 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 quite logical and justified. Thirdly, the current cost accounting 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 from operating profit/earning enables the management to evaluate its performance. Fifthly, the break up or details of values of assets and liabilities as given under the current cost accounting method represents a more accurate and realistic approach as to the financial position.

To remain unaltered for a period of three years, SSAP-16 came into effect since January 1, 1980 and applies to all public companies other than value based companies (e.g., insurance, investment, real estate etc.) and wholly owned subsidiary companies. So far as disclosure is concerned the current cost information is to be given in a note to the main accounts rather than by way of supplementary accounts. 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 have fixed assets and inventories and accumulated current cost depreciation are to be disclosed separately.

Delta Metals Limited, U.K. is one of the first major companies in U.K. to produce Current Cost Accounts. Examinations of Delta’s Accounts reveals that much simplification can readily are achieved through intelligent application of the principles and regard for materiality.

Example of Presentation of Current Cost Accounts: Following are the examples showing the application / current cost adjustments of current cost accounting in the various companies in U.K.

The Example based on Depreciation Adjustment (DA). Included in the Current Cost Balance Sheet of X Ltd., at 31st December 1998 were fixed assets valued at £550,000 which originally cost £500,000 and which were being written off on a 5 years straight line basis. The price indices relative to the fixed assets were:

| January 1998 | 110 |
| December 1998 | 130 |

We can compute the depreciation adjustment on an average basis as follows.

Average index for the year = \( \frac{110 + 130}{2} = 120 \)

All assets at gross current cost at 1st January 1998 = £550,000

Adjusted to average current cost during year = £550,000 \( \times \frac{120}{110} \)

Depreciation \(-\frac{1}{5} \times £600,000\) = £120,000

Less: Depreciation charged in Historic Account = £100,000

Depreciation Adjustment (DA) = £20,000
The Example based on Cost of Sales Adjustment (COSA) for example.

Stock at 1st January 1998 £100,000 Index 200

Stock at 31st December 1998 £140,000 Index 240

Assuming that stocks have risen steadily the year COSA is calculated as follows.

Average index for the year = \( \frac{240-200}{2} = 220 \)

<table>
<thead>
<tr>
<th>Historic Cost</th>
<th>Average Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Stock</td>
<td>£100,000 x ( \frac{220}{200} ) = £110,000</td>
</tr>
<tr>
<td>Closing Stock</td>
<td>£140,000 x ( \frac{220}{240} ) = £128,333</td>
</tr>
<tr>
<td>COSA</td>
<td>= £40,000 less 18,333 = £21,667</td>
</tr>
</tbody>
</table>

The figure of £21,667 represents the increase in stock value due to changing prices as distinct from changing quantities with 220 used as the average index through the year as computed above.
The Example based on Monetary Working Capital Adjustment (MWCA): For example, AB Ltd. has the following balances recorded in the accounts:

<table>
<thead>
<tr>
<th></th>
<th>Debtors</th>
<th>Creditors</th>
<th>Net</th>
</tr>
</thead>
<tbody>
<tr>
<td>1(^{st}) January 1998</td>
<td>600,000</td>
<td>400,000</td>
<td>200,000</td>
</tr>
<tr>
<td>31(^{st}) December 1998</td>
<td>800,000</td>
<td>500,000</td>
<td>300,000</td>
</tr>
</tbody>
</table>

Index No. January 1998 250
Index No. December 1998 300

Average index for the year = \(\frac{250 + 300}{2} = 275\)

```
Net Monetary Assets 1\(^{st}\) June 1998
\[
\begin{align*}
\text{Historic} & : 200,000 \times \frac{275}{250} = 220,000 \\
\text{Average}  & : \frac{300,000 \times 275}{300} = 275,000 \\
\end{align*}
\]
```

MWCA = 100,000 less 55,000

= £45,000

In this example debtors exceed creditor and the adjustment is a charge against profits.

Where creditors exceed debtors and prices are rising the adjustment will be a credit to profit but this should not exceed the cost of sales adjustment.

Current cost adjustment: The three adjustments typified above are totaled and applied to the historic profit to determine (before interest) the current cost profit:

i.e., £20,000 + £21,667 + £45,000 = £86,667
The Example based on Gearing Adjustment (GA). Assume, the abbreviated Balance Sheets of AB Ltd., in current cost values at the beginning and end of 1998 are as follows:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed Assets</strong></td>
<td>£550,000</td>
<td>£600,000</td>
</tr>
<tr>
<td><strong>Stock</strong></td>
<td>£200,000</td>
<td>£230,000</td>
</tr>
<tr>
<td><strong>Net Monetary Assets</strong></td>
<td>£200,000</td>
<td>£220,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>£950,000</td>
<td>£1,050,000</td>
</tr>
<tr>
<td><strong>Share Capital</strong></td>
<td>£400,000</td>
<td>£400,000</td>
</tr>
<tr>
<td><strong>Reserve</strong></td>
<td>£250,000</td>
<td>£350,000</td>
</tr>
<tr>
<td><strong>Sub-total</strong></td>
<td>£650,000</td>
<td>£750,000</td>
</tr>
<tr>
<td><strong>Loan Capital</strong></td>
<td>£300,000</td>
<td>£300,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>£950,000</td>
<td>£1,050,000</td>
</tr>
</tbody>
</table>

If the Current Cost Profit is £93,333, after the three adjustments similar to those for X Ltd., above but before interest of £28,000, tax of £25,000 and dividends of £40,000, the gearing adjustment would be:

Average capital employed for year = \( \frac{£950,000 + £1,050,000}{2} \) = £1,000,000

Loan = £300,000

Current Cost Adjustments = £86,667

Gearing Adjustment = \( \frac{\text{Loans} \times \text{CCA}}{\text{Total capital}} \)

= \( \frac{£300,000}{£1,000,000} \times £86,667 = £26,000 \)

Current Cost Profit = 93,333

Add: Depreciation Adjustment = 20,000

COSA = 21,667

MWCA = 45,000

Historic Profit before Interest and tax = 180,000
Current Cost Profit and Loss Account  
For year ended 31st December 1998

<table>
<thead>
<tr>
<th>Profit as per Historic Profit and Loss Account before</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest and taxation</td>
<td>180,000</td>
</tr>
<tr>
<td>Less Current Cost Adjustments</td>
<td>86,677</td>
</tr>
<tr>
<td>Current Cost Operating Profit</td>
<td>93,333</td>
</tr>
<tr>
<td>Gearing Adjustment (26,000)</td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>28,000</td>
</tr>
<tr>
<td>Taxation</td>
<td>25,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>40,000</td>
</tr>
<tr>
<td>Profit Retained</td>
<td>26,333</td>
</tr>
</tbody>
</table>

The profit retained of £26,333 does not equate with the change in reserves of £100,000 derived from the Balance Sheet. The difference incorporates the Current Cost Reserve and provisions for tax and dividends.

Canada

Another country in which inflation accounting approaches used by the companies in preparation of financial statements is Canada. The Canadian Institute of Chartered Accountants (CICA) has a pioneering role in setting APC standards in Canada – its proposal is the most comprehensive one in the subject in that country. After two EDs in December 1982 for the first time the CICA has included APC in its handbook of accepted practice. The standard is officially entitled “Reporting the Effects of Changing Price”, and is included in the supplementary information section 4510 of CICA Hand Book. CICA Hand Book guidelines carries an impressive legal weights because the important business statues viz, the Canadian Business Corporation Act and several provincials acts stipulate that the financial statements should be prepared in accordance with the CICA
Hand Book. However, the APC standard although included in the CICA handbook allows for information to be shown outside the financial statements as supplementary statement and not needed to be audited.

Section 4510 of CICA Hand Book continues to be the present APC standard in that country.

The Standard requires large publicly held companies to provide supplementary information about the effects of changing prices in their annual reports containing financial statements for years commencing on or after 1st January 1983. It requires information on certain items for which the effects of changing prices are likely to be most significant. The information required to be disclosed includes:

(a) The current cost of inventories and of property, plant and equipment at the end of the reporting period.

(b) The current year's increase in current costs of inventories and of property, plant and equipment.

(c) The net assets of the enterprise after restating inventories and property, plant and equipment on a current cost basis at the end of the reporting period.

(d) The amount of current cost income (loss) after reflecting the cost of sales and depreciation, depletion and amortization on property, plant and equipment on a current cost basis.

The Standard does not require the disclosure of income attributable to common shareholders on a current cost basis, it requires that the reporting entities provide sufficient information to permit the users of financial statements to compute income after
maintaining the common shareholder's interest under the 'financial capital' concept and the 'operating capability' concept.

To enable the users to assess whether the shareholders' financial capital in terms of constant dollars had been maintained, the Standard requires the disclosure of the amount of changes during the reporting period in the current cost amount of inventories and property, plant and equipment that is attributable to the effects of general inflation and the amount of gain or loss in general purchasing power resulting from holding net monetary items during the reporting period.

For computing income attributable to shareholders after maintaining their proportionate interest in the opening capability of the entity, the Standard requires the disclosure of a 'financial adjustment'.

The Canadian Standard does not require a 'monetary working capital adjustment' (MWCA). Therefore, all monetary liabilities are included in the 'net monetary liabilities' for the purpose of determining the amount of the 'financial adjustment'.

Either the Consumer Price Index for Canada or the Gross National Expenditure Implicit Price Index may be used as a measure of changes in general purchasing power of the Canadian dollar. This may, of course, affect comparability.

Before issuing the pronouncement on Canadian Standard, in Canada the practice of fixed asset revaluations exist, and many of the firms utilizing this practice indicate that they are in the process of writing off the appraisal credit, some by transfer to accumulated depreciation. At present the Gross National Expenditure Implicit Price Index is considered most appropriate index for the purposes of making general price level
restatement. The Canadian Institute of Chartered Accountants in this connection recommends that the general price level restatements should be applied to all assets, liabilities, revenue, expenses and not on a partial or selected item basis. However, general price level adjusted data need not be presented in the same detail as the historical cost financial statement. A very few companies have yet adopted the technique of general price level restatements. ²⁰

A few examples in regard to the practice of inflation accounting in Canada are worth quoting here these are:

1. The Dominion Tar & Chemical Company, Limited: ²¹

The company did restate the accumulated depreciation, as described in the following note appearing in its 1997 annual report as surplus resulting from restatements of certain fixed assets.

Extracts from the Annual Report for the year 1997: (Dec. 31, 1997): As of January 1, 1997, the book value of all building, plant, machinery and equipment acquired prior to the appraisal dates were restated (with additional allowance for depreciation since the appraisal dates) on the basis of depreciated replacement values as determined by the Canadian Appraisal Company Limited in 1989, 1990, 1992, and 1993, plus subsequent additions at cost. This restatement had the following effect:
### Balance Sheet at Jan 1, 1997

<table>
<thead>
<tr>
<th>Buildings</th>
<th>Accumulated Depreciation</th>
<th>Net</th>
</tr>
</thead>
<tbody>
<tr>
<td>118.8</td>
<td>54.9</td>
<td>63.9</td>
</tr>
</tbody>
</table>

### Adjustment to give effect to

<table>
<thead>
<tr>
<th>Description</th>
<th>Buildings</th>
<th>Accumulated Depreciation</th>
<th>Net</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restatement described above</td>
<td>26.7</td>
<td>(18.6)</td>
<td>45.3</td>
</tr>
<tr>
<td>Net Additions in 1997</td>
<td>15.9</td>
<td>-</td>
<td>15.9</td>
</tr>
<tr>
<td>Depreciation for the year (Net)</td>
<td>--</td>
<td>9.3</td>
<td>(9.3)</td>
</tr>
</tbody>
</table>

### Balance at Dec. 31, 1997

<table>
<thead>
<tr>
<th>Buildings</th>
<th>Accumulated Depreciation</th>
<th>Net</th>
</tr>
</thead>
<tbody>
<tr>
<td>161.4</td>
<td>45.6</td>
<td>115.8</td>
</tr>
</tbody>
</table>

2. The imperial tobacco company (Canada):  

The following are the extracts from the Annual for the year 1997:

Land is carried at current market value; all other fixed assets are carried at replacement cost. Real estate values are based on appraisals made by independent appraisers as of December 31, 1996 and 1997. Machinery and equipment were valued at replacement cost by company officials. The company proposes to restate fixed assets at current replacement cost every year and to establish annually the resulting increase in capital, which is reflected in the consolidated balance sheet in a “capital increment” account. Depreciation expense, based on these replacement costs, was deducted in determining “earnings from operations”. As fixed assets were retired, a portion of the “capital increment” arising from appraisals was transferred into retained earnings.
France

The France is the next West European country in which inflation accounting to revalue the assets is used. It (France), in 1945, was the first country to authorized revaluation and it remained in effect on a voluntary basis until 1959 when it was made mandatory for large companies. The France permit, but do not require, a revalorization of fixed assets, intangible, certain investments, receivable and payables. Further, the tax pay is free to choose which items to revalue. The amounts are computed by means of frequently revised published coefficients by years based on the wholesale price index. Legally these are merely maximums, but, as a practical matter, are generally used without further attempt at valuation. The procedure can be demonstrated by the following example.

Assume an asset was purchased in December 1944 at a cost of Fr. 10,00,000, with an estimated ten-year life. Assume also that depreciation had been taken annually at a fixed Fr. 1,00,000. Revalorization was carried out on December 31, 1948.

Cost Fr. 10,00,000 x 7.2 Official Coefficient for 1944: = Fr. 72,00,000.

<table>
<thead>
<tr>
<th>Year</th>
<th>Coefficient</th>
<th>Depreciation</th>
<th>Revalorized Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1945</td>
<td>3.6</td>
<td>3,60,000</td>
<td>8,70,000</td>
</tr>
<tr>
<td>1946</td>
<td>2.3</td>
<td>2,30,000</td>
<td></td>
</tr>
<tr>
<td>1947</td>
<td>1.8</td>
<td>1,80,000</td>
<td></td>
</tr>
<tr>
<td>1948</td>
<td>1.0</td>
<td>1,00,000</td>
<td></td>
</tr>
</tbody>
</table>

Net Revalorised Amount 63,30,000

Book Value prior to adjustment 6,00,000

Revalorization Surplus 57,30,000

Subsequent depreciation is now computed by amortizing the new value of Fr. 63,30,000 over the remaining six year useful life of the asset (or a revised useful life, if
Under this method, tax benefit is afforded even though the asset may have been fully depreciated, as long as it has a remaining useful life.

The surplus arising from revalorization is segregated and permitted to be used as a source of cash dividends, cash dividends, increase in nominal value of capital stock, and may sometimes be used to write off losses. Tax consequences vary with the choice.

In an effort to explain this procedure to American shareholders, SIMEA (France) presents the following note to the financial statements in its 1959 annual report.23

Under French tax laws, companies may recognise the loss in purchasing power of the French Franc by revaluing their fixed assets. The revaluation of physical properties may be based on estimates of current useful value with the limitation that the value thus found may not exceed the amount that would have been obtained by applying approved coefficients to the original cost of the properties and to the recorded provisions for depreciation. These coefficients which are published by the French Government are intended to give expression to the change in price level each year beginning with the year 1914. Upon recording such a revaluation, companies may subsequently deduct from taxable income depreciation computed on the basis of the higher amounts. The surplus resulting from revaluation is maintained in a special reserve for revaluation and may be used to increase the stated value of capital stock upon payment of a relatively small tax.

The company has revalued its properties on three separate occasions, at the end of 1945, 1949, 1951 on the basis of coefficients of revaluation authorised by the French Government as of those dates. Therefore, the company has charged against earnings depreciation on the higher amounts, as permitted by French tax law.
A "reserve for revaluation" is shown as a separate item under the general balance sheet caption, "Capital Stock and Surplus." This company has used portions of the surplus to increase the nominal value of its shares, and as a source of several stock dividends.

Fixed assets were carried in the accounts at these revalued amounts, and depreciation expense, based on these amounts, was deducted in the profit and loss statement in arriving at net operating income for the year. When assets were revalued, the credit was to "surplus from revaluation of fixed assets", which arose as follows:

Note 4 of the Notes to Financial statements explain the mode in which the surplus arise, which is as follows:

**Revaluation of Assets**

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (Fr.)</th>
<th>Reserve for Dep. (Fr.)</th>
<th>Net (Fr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1945</td>
<td>742,410</td>
<td>388,260</td>
<td>345,150</td>
</tr>
<tr>
<td>1959</td>
<td>2,107,968</td>
<td>1,253,245</td>
<td>854,723</td>
</tr>
<tr>
<td>1951</td>
<td>1,889,920</td>
<td>7,553,345</td>
<td>1,114,572</td>
</tr>
<tr>
<td></td>
<td>4,740,298</td>
<td>2,416,853</td>
<td>2,323,445</td>
</tr>
</tbody>
</table>

Foreign Currencies:

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (Fr.)</th>
<th>Reserve for Dep. (Fr.)</th>
<th>Net (Fr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1945</td>
<td></td>
<td></td>
<td>35,727</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2,359,172</td>
</tr>
</tbody>
</table>

Less: Stock Dividends:

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (Fr.)</th>
<th>Reserve for Dep. (Fr.)</th>
<th>Net (Fr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947</td>
<td>250,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1950</td>
<td>90,316</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1951</td>
<td>250,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1954</td>
<td>1,000,000</td>
<td></td>
<td>1,590,316</td>
</tr>
</tbody>
</table>

Excess of sales proceeds over book-value of machinery sold to UNICO

| Total: Fr. | 1,216,653 |

447,797

768,856
Belgium

Belgium officially known, as Kingdom of Belgium is one of the smallest nations of Europe, located in the northwestern part of the continent. This country introduced one time voluntary plan of inflation accounting largely limited to revaluation to fixed assets acquired before World War II and that too to industrial plant and equipment. In this country business firms were covered by the revaluation laws. The Belgium firm, Union Chimique Belge, show its fixed assets broken down into two categories in its June 30, 1959 Balance sheet:

1. Non-revalued Fr. 1,000.4 million; and
2. Revalued Fr. 375.3 million.

Both the revaluation reserve of Fr. 105.1 million and the accumulated depreciation appear in the capital section, the latter show in two accounts:

1. On non-revalued fixed assets : Fr. 552.4 million; &
2. On revalued fixed assets : Fr. 317.8 million.

It is indicated that there been no change during the year in the amount of the revaluation reserve.

The term revalorization has been used to describe an adjustment of asset values by means of the application of an index of price level changes. Several governments have passed fiscal laws providing for the most intricate price level adjustments. Perhaps the cost comprehensive of these laws is the France Finance Act of 1945.
Sweden

Write-ups of fixed assets, though legal in Sweden, are not generally resorted to, since no additional tax depreciation is permitted on the revaluations. To the contrary, the tendency of Swedish firms is to write down their assets through over-depreciations to the point of creating secret reserves.

Condoned by tax law, finns have been taking “free depreciation” on their machinery and equipment since 1938. This originally permitted complete freedom as to the amount to be deducted in any one year. Although limited to cost in total, any amount could be taken each year, even 100 per cent in the year of acquisition, or none in a loss year. More recently, the amount of depreciation that may be taken in one year has been limited to statutory percentages. Even so, a firm may take less than the maximum and defer making depreciation to a more favourable year. The extent of excessive depreciation is indicated in the 1959 annual report of the Swedish Ball Bearing Company under the caption, Depreciation on Capital Assets: Depreciation on property, machinery etc., amounted to Kr. 33,171,209 (Kr. 27,574, 605 in 1958) and is shown on 17. In view of current tax regulations, depreciation on machinery, tools, furniture, etc., acquired during 1955-1959 has been provided at 20 per cent of cost. Assets of this nature purchased before 1955 have previously been fully written off. Depreciation on building, etc., has been provided in accordance with the usual principles. Had the depreciation not been limited by current tax regulations and if the principles normally applied by the company had been followed by the company the year’s depreciation would have amounted to Kr. 40.3 million.
An indication of the impact of the limitation imposed by law is shown not only in the above note, but also by the fact that this company’s depreciation dropped sharply from Kr. 16.6 million in 1950 to Kr. 4.8 million in 1951, the year the first of several restrictions becomes effective.

A unique tax provision of Swedish law is called Investment Reserve for Economic Stabilization. Not essentially an accounting device, its result is to permit a deduction for capital outlays before they are acquired. One merely deducts up to 40 per cent of pre-tax profits and transfers the amount to a reserve; 40 per cent of this reserve is required to be deposited in a restricted bank account. Only with government permission may the amounts be expended, and, while there is no depreciation permitted on the assets so acquired, an additional 10 per cent of the cost is allowed to be deducted in the year of acquisition. The objective is to limit capital investments in times of high employment and defer such spending to times of low employment. Use of this provision is widespread.

In the 1959 annual reports of the Swedish Ball Bearing Company and AB Volve, both firms show the deduction for investment reserves in the profit and loss account. In the Volve report, for example, the deduction amounts to Kr. 28 million compared to net profit (after this provision) of Kr. 18.6 million. Volve described it as “appropriated to Trading Investment Fund”, while Swedish Ball Bearing Calls it “Provision for trade Equalization Accounts.”

Japan

Among the Asian Countries, Japan’s revaluations were started in 1950 after years of struggling with the historical cost system during a period of violent inflation. In 1950 the
Japanese Government for the first time placed into effect a series of asset revaluation laws as needed to adjust for fluctuations in price level. In 1954 the law was made compulsory as to depreciable assets of corporations. The statutes provided for revaluations based primarily on earning power, but amount of write-up was limited by prescribed maximums measured by price indexes. These laws stipulated criteria, which determined the companies, required to make the adjustments, and disclosed the procedures to be followed. The laws aimed are:

1. Adjusting conspicuous differences between the book value and the actual value of fixed assets resulting from inflationary trends after the war.

2. Establishing a fair distribution in the burden of taxation.

3. Providing a firm structure of corporate capital through the legal enforcement of adequate depreciation as provided by law.

4. Correcting undue disparity between the old and new stockholders.

Originally, the revaluation surplus was taxed at 6 per cent, whereas, with the third law, “special tax measures were passed for reducing or exempting revaluation and fixed assets taxes.” It was stated that “the surplus (arising from revaluation) was not to be used for any purpose except for charging the payment of the revaluation tax, absorbing of losses resulting from the sale of revalued fixed assets, and transfers paid-up capital.”

Under the Japanese systems, the indexes used vary with the asset to be revalued. For depreciable assets, the wholesale price index of the Bank of Japan, Tokyo, is prescribed, for land, the Urban land Price Index of the Kangyo Bank; and for all other assets, the
consumer price index of the Bureau of statistics. These are to be applied to the
depreciated cost computed on a declining balance basis.

For example, an asset acquired in 1945, revalued at the end of 1950, would have a book
value (based on a reducing balance rate of .206 and a scrap value of 10 per cent)
computed as: Cost (1-.206), or Cost x .315. This legal book value was to be multiplied
by an index computed as the ratio of the 1949 price index to that of the year of
acquisition. For 1945, the resultant ratio was 79, therefore, the maximum amount was set
at 24 (or 79 x .315). For convenience, the government published tables setting forth the
products of price and age ratios.

The major portion of the surplus created by this revaluation was permitted to be
capitalized after payment of the revaluation tax. Care was taken, incidentally, so that the
payment of revaluation tax could not cause the firm to pay more than its income tax
would have been without revaluation.

In their six months report of arch 31, 1957, Tokyo Shibaura Electric Company
Limited, disclosed in a balance sheet notation that on April 1, 1954, a reappraisal was
made, but not to the full extent allowable under the law. In the capital section of the
balance sheet a “Reappraisal Reserve” appears under capital surplus. A footnote explains
that a portion “of the reappraisal reserve was appropriated to wipe off the loss for the
term then ended.” In another section of the report, there is a reference to stockholders
approval of “capitalization of a portion of the reappraisal reserve and issuance of new
shares accompanying such capitalization”. In addition to this, the depreciation is
calculated on the reappraise values and is deducted as an expense for the term. The
reappraisal amounts for assets were decided according to the Special Measure Law for Assets Reappraisal.

**Nippon Telegraph & Telephone Public Corporation:**

The following excerpts from the prospectus indicate the procedures followed by the company on the subject of revaluation.25

**Plants & Equipment:** As provided for by regulations under the basic law relating to NTT, plant assets at April 1, 1954 were revalued upwards. Under the Assets Revaluation Law substantially all major Japanese companies revalued their fixed assets. The purpose of the revaluation law was to provide for depreciation charges adjusted for substantial monetary inflation, which occurred immediately after World War II. NTT adopted certain of the detailed indexes to be used for revaluation purposes, as set forth in the revaluation costs. Corresponding adjustments in accumulated depreciation were made simultaneously. Accordingly, plant and equipment accounts were increased by approximately 2,85,000,000 thousands yen and related reserves for depreciation by approximately 145,000,000 thousand yen; the net amount of the revaluation, 140,754,740 thousand yen (390,985 thousand U.S. dollars), is included in surplus arising from revaluation of plant and equipment. The results of the revaluation were approved by the Minister of Post and Telecommunication, with minor adjustments which have been reflected in the statement of earnings under “Other (charges) and credits.” Depreciation expense, based on the higher amounts was deducted as an “operating expense” in the “Statement of Earnings”.
Germany

Germany officially called “Federal Republic of Germany” (FRG) is another a major industrial country of north central Europe which enacted a revaluation plan of assets in 1949. The adjustment of price level changes in financial statements in this country is a voluntary measure. The present practice of valuation for general and tax accounting purposes is based on the principle of cost. These values, however, may no longer reflect the fair values at balance sheet date and also not the diminution in value that occurred during the financial year. The following, however, are the recommendations of the Institute Der Wirtschaftsprufer for public companies and such other enterprises that, because of other laws, have to prepare an annual report to stockholders.

Recommendations of the Institute Der Wirtschaftsprufer: In order to gain exact information of the true profit situation the Institute recommends that all enterprises engaged in industry and commerce, and other enterprises with significant non-monetary assets, determine at least for internal purposes the amount of profit that is required to preserve the operating capacity capital of the enterprise, and thus for the continuation of the enterprise and the security of its jobs. Furthermore, it recommends that enterprises closely control for their own purposes the impact which increasing replacement values have on the financial position of the enterprise.

As long as the amount which is needed to preserve the operating capacity capital of an enterprise and consequently accepts the fact that users of external accounts are left ignorant as to the amount actually required for operating capacity capital maintenance (which amount is included in the profit), recognition of capital maintenance in external
accounts will have to remain a voluntary measure. It is in line with this objective to indicate in a supplementary accounting how much of the annual profit, in the interest of preserving the operating capacity capital, should not be distributed. The following recommendation are primarily intended for public companies (Aktiengesellschaften) and such other enterprises that, because of other laws, have to prepare an annual report to stockholders. Other enterprise should take similar measures.

Australia

The Current Cost Accounting Steering Committee (CCASC) issued the Final Exposure Draft (FED) in 1982 as the Accounting for Price Level Changes (APC) standard in the country. Providing for asset replacement at higher costs though appropriations of retained earnings is the common practice in Australia. These are popularly known as “special depreciation reserves”, or “reserve for replacement of fixed assets”, etc. How these appropriations might be explained to stockholders is illustrated by the following excerpts from the 1958 Annual Report of Imperial Chemical Industries Ltd. (British).

Imperial Chemical Industries Ltd. (British):

Depreciation charges have been supplemented by the additional reserve built up appropriation out of the total profits each year since 1950 and amounting at 31st December 1957 to £ 50 million.

Another example is found in the Broken Hill Proprietary Co. Ltd. (Australia)

Extracts from the Annual Report for the year ended May 31, 1961:

Fixed assets were revalued and the related depreciation reserves were adjusted by amounts agreed to by the Board of Directors after considering valuations received,
possible obsolescence, and the age and condition of various units of plant. These new values established in 1960 were less than the estimated current replacement costs. The offsetting credit was to "assets revaluation reserve account". A portion of this reserve was permanently capitalized by means of a stock dividend. Depreciation expense was not based on the recorded revalued amounts for fixed assets. Instead, it was based on established replacement costs, which were higher than the new book values. The credit was to the "reserve for depreciation" account.

Recently, AMOCO Australia, in addition to reporting its results on historical cost accounting methods, has prepared a set of supplementary accounts for 1975 based on current value accounting to allow for the effects of inflation. Under this method, depreciation rose sharply because of revaluation of assets to replacement cost, reducing the 1975 profit to $A 3.18 million.

Under current value accounting total funds employed rose from $A 80.7 million to $A 119.2 million, largely through a $A 41.9 million increase in the valuation of the company's oil refinery near Brisbane.

AMOCO said its exercise highlighted the difficulty of obtaining an adequate return on investments in an inflationary period.

The practical acceptance by price approving authorities of these difficulties needed to be fully recognised.
Italy

Shortly following the action taken by the French, the Italians in 1946 attempted to handle revaluation in a very simple manner, viz., a single coefficient for all assets, regardless of the date of acquisition. Eventually, however, official coefficients were published for each year, gain back to 1914 acquisitions, and carried out to many decimal places. Again, these intended only as a maximum. The special equalization account created upon revalorization was to be used chiefly for increasing the nominal value of capital stock or for the issuance of stock dividends. The law was gradually expanded to permit restatement of buildings, plant, machinery, equipment, goodwill and holdings in other companies.

As an illustration of the presentation of revalorization data to stock holders, the following excerpts have been selected from Notes to consolidated Financial Statements in the 1959 annual report of an Italian company with Belgian subsidiaries.31

Note 1: Basic of Presenting Financial Statements: Under Italian monetary and Belgian tax laws companies have been permitted to recognise, to some extent, loss in purchasing power of the respective country’s currency through permission to restate assets (and related reserves) at amounts increases of cost on the basis of coefficients established under the law. The last revalorization enactment in Italy was in 1952 and related only to assets acquired in 1946 or earlier. As to the Belgian companies, the last revalorization of assets was made in 1949. Depreciation has been charged against income based on the higher amounts.
Note 2: Inventories. The inventories are valued at the lower of the previous year's price (actual cost or historical cost as revalorized in accordance with legal coefficients) or market to the extent that the quantities existed at the beginning of the year and at the lower of cost or market to the extent the quantities increased during the year.

Note 3: Investment in and advances to affiliated and associated companies: Investment in and advances to affiliated and associated companies are stated at or revalorized cost except that in certain instances where losses have been incurred the investment has been written down. Property, plant and equipment are stated at revalorized amount that as described in Note 1 with additions subsequent to the revalorization dates being stated at cost. The account resulting from revalorization of the assets was included with capital surplus on the balance sheet. The company indicates elsewhere that they have taken the maximum depreciation allowable under the law. Although no details of the revaluation surplus are given in the 1959 report, the following tabulation appears in Notes to Financial Statement in 1958 report: A summary of the revalorization of assets and the disposition of the credit adjustments is presented below:

<table>
<thead>
<tr>
<th>Description</th>
<th>Millions of Lire</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revalorization of fixed assets</td>
<td>1,18,923</td>
</tr>
<tr>
<td>Less: Revalorization of the related depreciation reserves</td>
<td>69,167</td>
</tr>
<tr>
<td></td>
<td>49,756</td>
</tr>
<tr>
<td>Revalorization of investments</td>
<td>22,381</td>
</tr>
<tr>
<td>Revalorization of inventories</td>
<td>11,937</td>
</tr>
<tr>
<td>Together</td>
<td>84,074</td>
</tr>
</tbody>
</table>
The above mentioned figure has been partially utilized as shown below.

Increase of share capital 44,359
By transfer to legal reserve 1,072
By transfer to general reserve 25
By transfer to depreciation reserve 38
By transfer to another company 19
For payment of income taxes 205
For covering losses 2,699
For contingencies 8
Elimination in consolidation 10
Together 48,435

Balance at December 31, 1958 Lire 35,639 (Million)

According to Italian law, this is a free, taxed reserve and can be used for:
   i. Stock dividends
   ii. Covering losses or liabilities, and
   iii. Providing for contingencies.
Conclusion

After going through the studies of inflation accounting practices in some foreign countries viz. United State of America, United Kingdom, Canada, France, Belgium, Sweden, Japan, Germany, Australia and Italy, we have come to the conclusion that accounting for inflation has been in practice for quite some time, during the last four decades there have been several proposals on how financial statements should be adjusted to show the effects of inflation. The earlier suggestions were to adjust the financial statements using general price index such as consumer price index. For example, in the U.K., SSAP-7 in 1974 and in the U.S.A. APB statement number 3 in 1969 and FASB statements in 1974 were suggested. These proposals were criticised because they did not indicate the effects or the changes specific to a particular enterprise. Price change for a given enterprise may vary considerably more or less than the general price changes. The next move came from the government sources and the suggestion was to move from historical cost to some form of current value accounting based on the concept of revaluing physical assets such as building, machinery and inventory in their value to the business. In the U.K. Sandilands Committee 1975, in the U.S.A. Security Exchange Commission's ASR-190 in 1976 suggested to revaluate the assets. However, the replacement of historical financial statements by the full-scale current cost financial statements as primary statement was first suggested in 1980 by the U.K's SSAP-16. The issuance of SSAP-16 is still considered an important landmark in the history of British accountancy.
Recent proposals have abandoned the complete restatement approach in favour of supplementary disclosure. The accounting profession in various countries had adopted different experiments with different approaches and alternatives in apparent recognition of the fact that there is theoretically no right answer and information provided by different methods of accounting for changing prices may prove valuable to different readers. These proposals are: in the U.S.A. SFAS-33 “Financial Reporting and Changing Prices” issued in Sept. 1979 by the FASB. In Canada Section 4510 of CICA Hand Book “Reporting the Effect of Price Changing” issued in December 1982 by the Canadian Institute of Chartered Accountants, Toronto. In Australia, Selective Exposure of Proposed Statement of Accounting Standard: ‘Current Cost Accounting issued in July 1982 by the Australian Accounting Research Foundation, Melbourne. In the U.K. SSAP-16 ‘Current Cost Accounting’ issued in March 1980 by the Accounting Standard Committee, London. The above proposals are not exhaustive but represents the serious effects made to come up with right answer for concepts and methods of adjusting financial statements for price changes. Thus, a most of the practices described above tend to reduce otherwise inflated profits resulting from changes in the price level, some might be considered sound, consistent, even standardized, others appear arbitrary and manipulative. But one fact is clearly evident, that these are not isolated example but practices that are being now adopted in a widespread manner. True these radical departure from our accounting standards are the results of multitude of influences.

The present position is that though there are very few countries which have officially adopted APC either as a superior substitute for historical cost accounting or
supplementary to it but a general consensus is yet to be obtained as to the proper APC standard to be perused. Obviously, there was never a consensus on any one method. In fact, this has been the greatest hurdle in the way of almost of every country thinking of introducing some system of inflation accounting. It is true of India as well. In spite of such consensus, it is felt that a method of inflation accounting most preferred by business enterprises could be given a fair trial at least to start with. Keeping this in view, we will study the inflation accounting practices in corporate sector in public undertaking in India in the next chapter.
References

1. The Survey is entitled: The Treatment of inflation in the published accounts of companies in Overseas Countries by R.W. Scapens of the University of Manchester, and is in the form of published report prepared for the Research Committee of the Institute of Chartered Accountants in England and Wales. The survey covers 18 countries. These are: Argentina, Australia, Belgium, Brazil, Canada, Chile, Denmark, Federal Republic of Germany, France, Italy, Japan, the Netherlands, Norway, Peru, Sweden, U.S.A., and Uruguay.

2. For example revaluations were required to be incorporated in accounts by the Japanese authorities in 1954 and by the French authorities in 1959.


5. Depreciation and High Cost Committee on Accounting Procedure (AICPA) December 1947.


9. As we know, one of the strongest criticism of replacement cost accounting is that if one intends of replace plant with something entirely different because of technological change, the meaning of replacement cost may be hard to define.


12. See Appendix A for the text of the SFAS-33 of the FASB (U.S.A.).

13. Income from continuing operations is defined as income after applicable income taxes but excluding the results of discontinued operations, extraordinary items, and the cumulative effect of accounting changes.

14. These statements were presented in the annual reports of the companies mentioned here.


16. AICPA: Accounting Research Study No. 6, p.173

17. Explanatory Note (Paragraph 3) to Statement of standard Accounting Practice No. 7 (SSAP-7) issued by the professional bodies of the U.K. in May 1974.


23. SIMCA (France): Extracts from the Annual Report for the Year ended 1959, Notes to Financial statements, Prospectus, dated April 17, 1959, pp.32-35.

24. See the Annual Reports of both the firms for the year 1959.


26. Maintaining the "Substantialistic Value" (Substanzerhaltung) of an enterprise when determining the annul profit, Institute Der Wirtschaftsprufer, Germany, (translated version), October 27, 1975, p.2.

27. In Germany these are known as Aktiengesellschaften.
28. Maintaining the "Substantialistic Value" (Substanzerhaltung) of an enterprise when
determining the annul profit, Institute Der Wirtschaftsprufer, Germany, (translated
version), October 27, 1975, p.2.


31. Montecatini General Mining & Chemical Corporation (Italy), Annual Report
1960.