INTRODUCTION

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Something that was widely accepted forty years ago might have either gone out of taste or practice due to new developments or might have been left out of use because of its otherwise uselessness. In the twentieth century the field of accounting has experienced a good amount of development including the contemporary issues like Human Resource Accounting (HRA), Social Responsibility Accounting (SRA), from its traditional base. Now, it does not tell about profit and financial position only but also goes ahead to provide 'socio-economic' data for the decision-making. Earlier, the purpose of accounting was only to serve the owner but today it serves all the interested parties viz. investors, research scholars, society, politicians, management and Government etc.

The accounting, in the present era, has extended its fields from mere 'stewardship' to the management as well as to the society. Stewards, in the earlier
times, used to be appointed by the owners to keep their property and capital safe and operative. The stewards used to render an account of periodicity of their stewardship, and this notion still lies at the root of financial reporting. The method of keeping these records, called Book-keeping, remained primitive until fairly recent times. The concepts and procedures of accounting in practice at present have their origin in the methods used by the businessmen of Italian City States during the early part of the Renaissance. The main principles, known as Italian Method, were set out by Luca Pacioli in his famous treatise "Summa de Arithmetica, Geometica, Proportioni et Proportionalita" published in 1494 in Venice. Later on, this Italian Method was known as 'Double entry book-keeping' system. In those days, stewardship accounting played a significant role during the commercial expansion in the Western Europe which followed the Renaissance and characterised that phase of Capitalism known as 'Commercial Capitalism.' In a nutshell, stewardship accounting meant the record keeping of transactions, investments and the debts to be taken and given. Industrial Revolution gave birth to the 'Financial Accounting.' Financing of long term capital and social frame experienced big change. The birth of Company (JSCO) organisations led to share-capital. In the companies, the liability of the holders was limited to the value of shares. The concept
politics of the mid 19th century in England. The Parliament of that country made the disclosure of accounting information to shareholders a condition attached to the privilege of Joint stock status and of limited liability. The accounting information induced P. & L. A/c and B. sheet (i.e. Financial Accounting). So, the disclosure as such created an initial step of public involvement to some extent. Legalities also came up to the disclosure of information of the companies' affairs through Reports. It started helping the investors and employees by providing with reliable and sufficient information in order to be able to make efficient investment decisions. The social significance of financial accounting has increased. "After the failure of a large private firm in Germany in the early 1970s, for instance, there was consternation that most employees had no idea that the firm was so fragile. More demand of disclosure to employees increased with the growing strength of the workers participation movement. So, to some extent, the Social Responsibility Accounting also started to grow" (Underdown & Giautier, 1976).

Industrial management was also coming up very fast from the Industrial Revolution of the 18th century. Josiah Wedgwood developed costing techniques as guides to management decisions. The genesis of
modern management with its emphasis on detailed information for decision making provided a tremendous impetus to the development of management accounting in the early decades of 20th century, and in so doing considerably extended the boundaries of accounting. Management Accounting has proved an important field of accounting because it met the changing socio-economic needs of the company organisations.

A new phase in the field of accounting emerged with the social revolution in the last 20 or 25 years. This phase is of Social Responsibility Accounting. Such accounting considers the social effects of business decisions and their economic impact. In the time going at present the social awareness is in full swing. This awareness increases the businessmen's responsibility to the endless social problems along with the profitability. So, the concept of growth and profits of business traditionally measured by income statements and Balance-sheets is considered to a narrow sense of accounting. Thus, the accounting started to include the role played by business enterprise in solving social problems. The accounting has started playing an important role in the activities of Government Agencies which are concerned with some of the serious social problems such as urban congestion, poverty, pollution and crime (Estes, 1973).
Accounting plays an important role in measuring national economic health, and has the potential to contribute to the development of national measures of the quality of life (Terleckyj, 1973).

But all these emerging roles have given birth to many problems to the persons working for accounting activities and process. These problems are:

1. As accounting has become an inter disciplinary subject, the accountant is required to have the knowledge of a broader area so that he may prepare the accounts for an efficient use of decision making. The accountants who have attained the traditional knowledge of accounting and are of the age of 50 years or more, are not capable of integrating the accounting skills particularly of Human Resource Accounting, Inflation Accounting and Social Responsibility Accounting etc.

2. New technology and mechanisms have invaded the field of accounting. These present threats to the accountants who have only the traditional knowledge.

3. Still, in accounting no concrete and scientific method has come up regarding the measurements
of many things like 'valuation of inventory' depreciation charge etc. The choices leave the good size of compartment for controversies. These controversies have not allowed the contemporary issues of accounting to develop and become popular.

4. The external reporting and auditing have attracted much thinking in the current period. The people who are, directly or indirectly, interested in the company organisation have started to think that accountants have the dexterity to prepare the 'window-dressing' type of financial statements. This thinking decreases interest of accountants in the new and contemporary issues of accounting. This situation has been succinctly stated by Gordon (1967) as:

"The Principles of accounting are a sturdy set of tools, but they are deteriorating rapidly under the impact of radical changes taking place in the nature of business operations. Principles that were satisfactory during 1930s are no longer adequate today, and unless we begin bringing them up to date we will soon reach a state of affairs in which income and other data of financial statements produced with the tools of the 1930s will leave the reader of financial statements completely misinformed."

Due to above mentioned problems, accountants face some consequences of interactions with several systems in the organisation and outside the organisation, new concepts of accounting theory (viz. Financial Reporting, Value and income measurement,
Accounting for price level changes, increasing financial information, and other issues) etc. Other problems may be of new accounting methodology for transition from one aspect to another, and new legislation and accounting standards.

Having these above mentioned problems and consequences (Problems and consequences have been mentioned in short), accounting and accountant serve a lot to the users of accounting information. Here, users mean the people who have vested interests in business organisation-Management, debtors, creditors, investors, customers, employees and society at large.

Accounting Information as an Aide to Resource Allocation:

Accounting data provide an information to the allocators (Directors, Chairman or Management) about how the available resources (with the characteristics of scarcity) should be allocated to different activities so that the maximum profits may be earned with minimum costs. In other words, the optimal decisions may be taken by the management regarding the best allocation of resources under control. Later on, accounting information is helpful in assessing and analysing the actual performance of men, materials, machines and money. With all other techniques of accounting, the inflation-accounting may provide
better information to the allocators (management and shareholders) in connection with fixed assets, monetary items (as discussed later in this very Chapter), allocation of profits to reserves and provisions etc. Even now, the Accounting Information is always based on 'Historical-Cost Accounting-Method'. But the proponents of inflation-accounting argue that HC-accounting stresses on "Tell it like it was", whereas I-accounting focusses on "Tell it like it is".

It is true that Accounting-information certainly helps in resource-allocation, decision-making, planning, controlling etc. But the question that arises is accounting-information be based on 'Historical-costs' or 'Replacement-costs'. It is too difficult to say anything concrete in favour of any of the bases. To make something clear, the following two pages have been written in support against.

Historical Cost Accounting - A Defence:

Historical Cost Accounting (HCA) has many answers to the big field of accounting by virtue of its having to come to stay as widely accepted accounting-procedure. Yuji Ijiri (1979), presented the 5-arguments in favour of HCA as given below:
(1) Historical cost valuation is the only valuation method which includes, as an integral part of its valuation procedure structured on the double entry book-keeping system, the essential requirement of equity accounting that every actual change in the resources of an entity be recorded by related inputs and outputs so that it can be traced and identified whenever necessary.

(2) Historical Cost Valuation provides data that are less disputable than data provided under other valuation methods currently being proposed - an essential requirement in equity accounting.

(3) Historical Cost Valuation, by refusing to recognise holding gains and losses, is inline with the spirit of maintaining the status quo unless changes (in income) are proved to be necessary beyond any reasonable doubt. This spirit is essential for solving conflicts of interest and maintaining order and stability in the society.

(4) HC-accounting and valuation provides data that are useful for decision-making by insightful managers and investors in-so-far as history is the only basis for predicting the future.

(5) HC-Valuation is, among all valuation methods currently proposed, the method that is least costly to society, considering the social costs of recording, reporting, auditing, settling disputes etc.
But this defence is true only when the value of monetary-units remain stable. It is not possible in any economy in general & in a developing economy (like India, Pakistan, Sri Lanka etc.) in particular. Since 30s, almost every economy of the world has met with inflationary tendency. Therefore, the advocates of 'Inflation -Accounting' disfavour the preparation of financial-statements according to HC (or conventional) system by giving certain reasons. These reasons or criticism of HCA are mentioned in the coming paragraphs.

Reasons to as in for Inflation-Accounting:

The price-changes are not considered under the system of 'Historical-Cost-Accounting (HCA). The assets are written in the Balance-Sheet at their purchase-price minus depreciation to the date of preparation of the Balance-Sheet. As a matter of fact, the value of assets changes with the change in prices of those assets. Similarly, the sales are recorded at the present market prices while the inventories are recorded at M.P. or H.C.w.e.l. The goods sold may include the items which might have been purchased in earlier years when the prices were lower than the prices of current year. So, neither the Balance-Sheet nor the income-statement (based on HC) shows the perfect position of the business from the operations and financial point of view. Therefore, on this logic, the need arises to adjust the
price-level changes in accounts as such changes bring with them some amount of distortions and problems in Accounts and their reports. These distortions and problems, known as limitations of HCA, have been enumerated through the following points:

(1) In-accurate Profits: HCA portrays the incorrect amount of profits during the inflation period because:

(a) The depreciation charged, as per HCA, on the original or w.d.w.of fixed assets and not their current value. The depreciation so charged would be unable to give that much amount of repurchase of that concerned asset because of higher prices at present/or at the time of repurchase. The profits would be swollen when the depreciation (HCA) is matched with sales at current prices.

(b) The profits are expanded abnormally when the difference of sales-revenue (at current prices) and cost of goods sold (at HC) is taken. The mixing up of holding-gains and operating gains emerges as such. 'Holding gain' is that gain which arises on account of having held the item over a period of inflation (i.e. a period of prices-rising). Operating profit refers to that profit which results on account of trading or operating
activities of the business. For example, suppose a company purchased a set of goods for Rs.10,000. These goods were sold out for Rs.14,000. On the sales making day, the same set could be purchased for Rs.11,800. Then the holding gain would be equal to Rs.1,800 (i.e. Rs.11,800-Rs.10,000). The operating profit would be to the tune of Rs.2,200 (i.e. Rs.14,000-Rs.11,800). Therefore, it may be said that both gains are mixed, in HCA method, in the profit of Rs.4000 (i.e. Rs.14,000-Rs.10,000). So, the profits are expanded abnormally.

(c) When there is inflation in the economy, the borrowers cut the fruits of gains whereas the lenders are losers. Here again, for instance, if a company borrowed Rs.20,000 when the price-index was, say 100 and lent Rs.10,000 at the same time. When Balance-Sheet is prepared (say on 31st December) the price index is 120. Assuming no return is there in either case, the borrower company would gain:

\[
\text{Rs. } \frac{[(20000 \times 120) - 20000] - [(10000 \times 120) - 10000]}{100} = \text{Rs. } 4,000 - \text{Rs. } 2,000 = \text{Rs. } 2,000.
\]
In Historical Cost Accounting method such gains /losses are shown nowhere in the books.

(2) If the prices are climbing up, the Balance-Sheet prepared under the HCA can not reveal the accurate financial position as the items are not shown on real-values. The value of fixed assets is quite misleading. This may be cleared by taking the following example.

Say, a machinery was purchased for Rs.50,000 on January 1, 1980. On this day the price-index was (say) 125. Another machinery was purchased on 1.1.1986, when the price-index was 150, for Rs.75,000. Both the machines will be shown in the Balance-Sheet for Rs.1,25,000 without considering the price-indices of 1980 and 1986. In America it is called "Constant-Dollar" (CD) Accounting. The real worth of machinery would not be reflected in the Balance-Sheet in Historical-Cost-Accounting Method.

(3) The problem of replacement also comes in the way when HCA is adopted for financial statements. A man of accounting knows very well that depreciation is levied on fixed assets for the purpose of replacement after a specific-period of use of such assets. The amount of depreciation goes on accumulating. The amount of so accumulated-depreciation is used
to replace the concerned asset. The depreciation is charged on HC. Prices proceed without any entanglement. So, a good size of breach comes between the accumulated depreciation and replacement cost.

In other terms:

\[(\text{Total of Accumulated Depreciation} + \text{Realised Scrap Value}) < \text{Replacement Cost} \ldots \ \text{(In Inflationary situation)}\]

Moreover, during the period of inflation the profits are overstated. Such overstated profits lead to higher bonus and bigger dividends. These lead to erosion of working capital. Consequently, financial strain comes on the business. It can be made clear with the help of this example. A company commenced some business with a capital of Rs.1000000. It purchased 10000 units at Rs.100 each. These units were sold out for Rs.11,00,000. The repurchase price of such units has come (on the day of sale) to Rs.10,50,000. In the absence of tax, extra-expenses (assume), the profit was of Rs.1,00,000. The dividend distributed was Rs.50,000 (say). The balance of profit and Rs.10,00,000 would be used to buy the items. No amount of W.C. would increase in the business. So, HC leads to the erosion of the working capital in the business.

In addition to the above limitations of HCA, the others may be: Balance-sheet will not disclose
accurate financial position, window-dressing disclosure, unrealistic comparison of financial statements with other business organisations (particularly when two organisations have different dates of establishment).

These limitations of Historical Cost-Accounting motivated the accountants of England and America to adjust the increased prices in the accounts so that the exact financial position may be revealed by the financial statements based on the Price-Changes Accounting or Price-Level Changes Accounting or Inflation Accounting. Now in rest of the chapter, the discussion would focus round price-changes, their types, approaches to Inflation Accounting, Conversion-process, Adjustment and on 'Inflation-Accounting in India.'

Somelmes on Inflation:

In real life two things are certain: one is 'man's going from the world' and another is 'Tax'. However, one more thing may be added in this sequence the inflation. Inflation means that value of every currency in the world steadily decreases. In India, it was easy to ignore the impact of inflation prior to 1950s as the insignificant changes were there barring 1947 to 1948 (when it was 21.8%). But after 1957, inflation never looked back except in 1968 (-1.2%) and 1975 (1.1%). General price level has been showing
'going-up' trend. Indian currency has been experiencing a significant decline in its purchasing power. A wonderful thing (almost a dream) is told by the people who have attained the age of 50 years or more. They tell:

"We used to go in the market, when we were young with one aanna (6 paisa) and come back with many bags full of different commodities." They further say: "Aanna ser (say one kg.) Ghee, Rupiah ka mann Gehoon (wheat)" etc. etc. in 40s and 50s.

But now, it appears to be a non repeatable phenomenon and a dream. Now the rate of inflation is compounded. The effects of this phenomenon are deleterious in the sense that many companies in India are facing the problems of: liquidity, replacement, production capacity and comparability etc. In 1980, one study noted, some companies in America paid out dividends in excess of net income after the income had been adjusted for price-level changes. As a consequence, the accounting and financial world was presented with challenges, decisions, and opportunities. Accountants, professionals, auditors, academicians and others are becoming receptive to imaginative proposals for improvements in financial-reporting. A difficult, exciting, and extensive experimental and educational process lies ahead in India regarding 'Inflation-Accounting'. Before we have consensus on what changes to make and
what new approaches to adopt, all of the parties concerned (Academicians, professionals, chartered-accountants and other users of financial reports) need to understand the alternatives and grasp what the new information is intended to portray. Such is the purpose of this chapter hereafter.

**Approaches To Financial Reporting And Inflation:**

Traditionally, preparers and users of financial statements have found that cost is generally the most useful basis for accounting measurement and reporting. As a result, existing Generally Accepted Accounting Principle (GAAP) requires that most assets and liabilities be accounted for and reported on the basis of acquisition cost (also called Historical Cost). This principle also focuses on the Reporting model from Historical-Cost point of view. However, many accountants are not happy with the present reporting model noting that historical cost financial statements have severe limitations (as mentioned earlier). Criticism gets strength when one perceives the effects of double-digit inflation (as in our country the situation has been in 1990s). At such times cost is no longer adequate because the cost figures of a year before are comparable to current cost levels. To meet the criticism, three different solutions have been offered:-
(A) General Price Level Method;
(B) Current Value Accounting or CCA;
(C) Current Value/General Price Level Accounting.

These have been discussed here as under separately.

General Price Level Accounting:

The currency of any nation is the medium of exchange. The amount of goods and services for which the currency (say rupee) can be exchanged is called the real value of the currency or in other terms "Purchasing Power." In the environment of rising-prices or declining prices, the purchasing power (PP) of the currency decreases or increases respectively. For example, in 1980 an agriculture-farm could buy the tractor for Rs.1,00,000. In 1990, the same tractor's purchase price was Rs.2,00,000 (say). It is a change in price of a specific item. The aggregation of specific prices at any particular time constitutes a general-price level (GPL). A general price level change recognises the change in the value of money in all its uses (often called General-Inflation). The purchasing power of the currency may be known with the help of published indices (as in India RBI publishes in its bulletin every month). These indices can be used in Accounting to adjust historical costs for changes in general purchasing power. Hereafter, the word "Rupee"
would be used in place of currency. It is fair to say, however, that the general indices available all the time are reasonably useful to most persons and business managers as gauges of the change in the PP of the rupee. The indices of price change in India regularly published by RBI are:

(1) The Wholesale Price Movement (All Commodities);
(3) Commodity-wise price-indices;
(4) Security prices indices.


Conversion or Restatement in Common Rupees:

The conversion of historical cost based data is made by multiplying the amount to be restated by a fraction. The current price index is the numerator and the denominator of which is the index of prices that prevailed on the day related to the amount being restated. Say, the cost of a machinery purchased on 1.1.1980 was Rs.50,000. It may be converted in December, 1992 rupees as follows:

$$\frac{1992 \text{ Index}}{1980 \text{ Index}} \times Rs.100 = \text{Cost of machinery in terms of 1992 rupees.}$$
To further illustrate the method of conversion of historical-data of financial statements, assume the facts given in Table A-1 relative to acquired assets and the preparation of financial statement in 1992 (CPI-4 are hypothetical):

<table>
<thead>
<tr>
<th>Year</th>
<th>Acquisition Cost</th>
<th>CPI-4 Price-Indiex</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>50,000</td>
<td>80</td>
</tr>
<tr>
<td>1978</td>
<td>50,000</td>
<td>95</td>
</tr>
<tr>
<td>1984</td>
<td>50,000</td>
<td>150</td>
</tr>
<tr>
<td>1992</td>
<td>50,000</td>
<td>250</td>
</tr>
</tbody>
</table>

To express all these acquisition costs in terms of one year's prices, say 1992, the conversion process is revealed in Table A-2.

<table>
<thead>
<tr>
<th>Year</th>
<th>Converted Cost</th>
<th>Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>Rs.50,000x250/80</td>
<td>1,56,250</td>
</tr>
<tr>
<td>1978</td>
<td>Rs.50,000x250/95</td>
<td>1,31,579</td>
</tr>
<tr>
<td>1984</td>
<td>Rs.50,000x250/150</td>
<td>83,333</td>
</tr>
<tr>
<td>1992</td>
<td>Rs.50,000x250/250</td>
<td>50,000</td>
</tr>
</tbody>
</table>

4,21,162
Thus, total acquisition cost of the machinery Rs.2,00,000 is modified (converted) on a General Price level to Rs.4,21,162 in terms of year 1992 prices.

Monetary and Non-Monetary Items:

The meaning of monetary and non-monetary items of financial statements has already been given. The classification of such items is compulsory in the sense that monetary-items need not conversion whereas the non-monetary items need restatement into current-rupee value. Here a statement of monetary and non-monetary items is given as below:

(1) Monetary-items:

Assets:
- Cash in Hand
- Demand Bank Deposits and Time Deposits.
- Preferred stock (non-convertible and non-participating).
- Bonds (other than convertible)
- Accounts and notes receivable
- Allowance for doubtful accounts
- Loans to employees
- Long term receivables
- Refundable deposits
- Advances to unconsolidated subsidiaries
- Cash surrender value of life Insurance
- Advances to suppliers (not on a fixed contract)
-Deferred income-tax changes

(i) Liabilities:
- Accounts and Notes payable
- Accrued expenses payable
- Cash dividends payable
- Advances from customers (not on a fixed price contract)
- Accrued losses on firm purchase commitments
- Refundable deposits
- Bonds payable and long term debt
- Unamortised premium or discount on bonds or notes payable.
- Convertible bonds payable
- Deferred income-tax credits

Non-monetary Items:

Assets
- Inventory (other than inventories used on contracts)
- Investment in common stocks in most situations
- Property, plant and equipment
- Accumulated depreciation of property, plant & equipment
- Purchase commitments (Portion paid on fixed price contracts)
- Patents, trademarks, licenses, and formulas
- Goodwill
- Deferred property acquisition costs
- Other intangible assets and deferred charges

Liabilities:
- Sales commitments (Portion collected on fixed price contracts)
- Obligations under warranties
- Deferred investment tax credit

Items Requiring Individual Analysis:

Assets:
- Investment in preferred stock (convertible or participative) and convertible bonds.
- If the market values the security primarily as a bond, it is monetary; if it values the security primarily as a stock, it is non-monetary.

Inventories
- If the future cash receipts will not vary because of future changes in prices, they are monetary. Goods priced at market upon delivery are non-monetary.

Prepaid insurance, advertising, rents and other payments
- Claims to future services are non-monetary. Pre-payments that are deposits, advance payments or receivables are monetary because the pre-payment does not obtain a given quantity of future services but rather is a fixed money offset.

Pension, sinking and other funds under enterprise control
- The specific assets in the fund should be classified as monetary or non-monetary.

Liabilities:
- Accrued vacation pay, if it is paid at the wage rates as of the vacation dates and if those rates may vary, it is non-monetary. If they do not vary, then it is monetary.

Deferred revenue: Non-monetary if an obligation to furnish goods or services is involved.
- Accrued pension obligations
- Fixed amounts payable to a fund are monetary; all other amounts are non-monetary.
Special-items:
- Deferred income tax charges and credits are monetary
- Preferred stock (stockholders' equity) is a monetary item.

Note: This above statement is adopted from "Financial Reporting and Changing Prices", Statement of Financial Accounting Standards No.33.

Inflation And Two-types of Itmes:

The holders of money sacrifice their purchase power in the inflationary trend in the economy because a given amount of money buys progressively fewer goods and services. The same loss occurs when any monetary asset is held during the inflationary situation in the economy. Gains also occur in case of monetary liabilities. These losses and gains are called inflationary losses and gains. Also called purchasing power losses or gains. The FASB in Statement No.33 calls them "Purchasing Power gains or losses or net monetary items (1979).

Non-monetary items on the other hand do not represent a fixed claim to receive or pay cash. To clarify the effects of holding a non-monetary asset during increasing prices trend, say a company has the following Balance-sheet at the beginning of the year:

<table>
<thead>
<tr>
<th>Balance-Sheet (Opening)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory Rs. 20,000</td>
</tr>
<tr>
<td>Owner's Equity Rs. 20,000</td>
</tr>
</tbody>
</table>
If the price level doubles and the inventory was purchased in the starting of the year, then the Balance-Sheet in CPP will be as below:

<table>
<thead>
<tr>
<th>Balance-Sheet (Closing)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory Rs.40,000</td>
</tr>
<tr>
<td>Owner's Equity Rs.40,000</td>
</tr>
</tbody>
</table>

In short, monetary assets and liabilities are converted in rupees of CPP in the historical rupees Balance-Sheet. The detailed example with solution is given at the end of the chapter.

**Purchasing Power Gain or Loss:**

The monetary-items' conversion and their analysis reveals the effectiveness of the management in coping with the changes. The computation of purchasing power gain or loss on net monetary items involves preparing a detailed statement of sources and uses of monetary items for the period under consideration, restated item by item. In this procedure, first of all, total net monetary items at the beginning of the period are calculated. These items are converted to end-of-year rupees to ensure that all monetary items are stated on the same price level basis. It is required for comparison purposes. Current period monetary items need not be changed because they are already stated in end-of-year rupees. The sources and uses are converted
on the basis of average price index because these items occur during the year. The net monetary items at the end of the year on a historical cost basis are equal to the monetary items in the beginning plus net sources of items. The net monetary items (converted) are compared to the monetary items (Historical) to determine whether there is gain or loss in purchasing power. The conversion of monetary items is made only for the purpose of computing the gain or loss from holding net monetary items. The restated monetary items are not reported on financial statements.

Positive And Negative Points For CPP:

The positive points associated with current Purchasing Power (CPP) are as follows:

1. Current Purchasing Power accounting provides the management with an objectively determined quantification of the impact of inflation on its business operations.

2. The data adjusted on the basis of current indices eliminate the effects of inflation. The enterprise starts following the same procedure by which the intra-firm comparison of financial statements become more objective and rational. The comparability of one firm also becomes more intelligent.

3. Along with the adjusted data, the historical cost accounting data are also preserved.
4. Inventory, block of fixed assets and depreciation are valued accurately.

Contrary to the above positive aspects of current purchasing power, some negative points (or weak-points) of this conversion are also submitted. These are:

1. Cost of conversion is bigger than the benefits.
2. All the users cannot follow the converted financial statements very well. So, sometimes it creates confusion among them.
3. Restating the 'value' of non-momentary items at historical cost adjusted for general price-level changes is no more meaningful than historical cost alone, that is, it suffers all the shortcomings of the historical cost method.
4. The reported purchasing power gain from monetary items is misleading because it does not necessarily represent successful management or provide funds for dividends, plant expansion or other purposes

Professional Pronouncement:

In 1963, the AICPA published 'Accounting Research Study No. 6', "Reporting the Financial effects of price-level-changes", which recommended that constant dollar accounting (Current Purchasing Power) information be reported on supplements basis (staff
of the Accounting Research Division, 1963). After this, in 1969, APB noted that "General Price-level adjusted financial statements present useful information that is not available from historical dollar statements" and therefore encourage their use. However, the APB indicated that general price-level information was not required for fair presentation of financial position and results of operations (APB statement No. 3, 1969). In May, 1974 the Accounting Standards Steering Committee in U.K. issued a proposal for constant dollar financial statements. It was followed in December, 1974 by the FASB in U.S. and the Institute of Chartered Accountants in Australia, both of whom similarly proposed adoption of financial reporting in units of general purchasing power (Exposure Draft, FASB, 1974). The Canadian Institute of Chartered Accountants issued a similar proposal in July, 1975. Later on, in June, 1975 Australia took different step in favour of CCA.

Current Value Accounting:

Value is what assets are worth to the particular person, for a particular purpose, and at particular point in time. Hence the word is generally precessed by a descriptive adjective, such as going concern value, re-sale value, liquidation value, market value, present value, current value, fair
value, book value, net value realisable value, exit value, appraisal value and others. Value and valuation are two different things but inter-related in the sense that accounting process of valuation results in assignment of an amount that represents a value generally either historical entry exchange value or historical exit exchange value, which in conventional accounting is cost and selling price respectively. The point is, that accounting process at valuation, because of its pre-occupation with the historical exchange price has contributed only a small portion of its information potential. Determining, which basis of valuation to adopt depends largely on the answers to the question: "What is the objective of Financial Statements?" Multiple answers may require multiple disclosure of values.

The Current Value Approach:

The term current value has been adopted as a generic term. The most common concepts of current value are: (1) Present value-discounted future cash flows. (2) Net realisable value current cash equivalents and (3) Current cost. The present value is measured by discounting at an appropriate interest rate, the future estimated net cash inflows or cost saving, of the items being valued. Present value is frequently viewed as an ideal basis for current valua-
tion of resources and obligations because it is more consistent with the users objective of predicting future cash flows (Stabus 1961). Net realisation value is based on premise that value of assets is the selling price of the assets in the market less the cost of disposal, instead of its purchase price or replacement cost (Chamber, 1966). The advocates of this approach believe that the market value or current cash equivalent is the best means available for measuring the value of assets of business and the changes in the market values should be reported in net income immediately. This mode is not good for the assets which do not have a ready market price. Current cost is the cost of replacing the identical assets owned, that is, of the same age and of the same operating capacity (Rebsine, 1973, Edwards & Bell, 1961, Largay Livingstone, 1976). Current cost may be approximated in a variety of ways but is computed by applying a specific price index to the historical cost or the book value of assets.

Some Examples of C.C.A.:

Example 1. (Cost of Sales Adjustment):

Assume that opening stock of Rs. 1,00,000 (when index is 100), purchases of Rs. 5,00,000 (average index 120) and closing stock of Rs. 1,50,000 (Index
150) are given. The adjusted cost of sales will be as under:

<table>
<thead>
<tr>
<th>C.C. Values</th>
<th>Historical Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Rs.)</td>
<td>(Rs.)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Opening stock (Rs. 100000)</th>
<th>120</th>
<th>120000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase (Rs. 500000)</td>
<td>100</td>
<td>500000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>620000</td>
</tr>
<tr>
<td>Loss:Closing Stock (150000 x 120)</td>
<td>-120000</td>
<td>-150000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>500000</td>
</tr>
<tr>
<td>Therefore Cost of Sales</td>
<td></td>
<td>500000</td>
</tr>
<tr>
<td>Adjustment</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>500000</td>
</tr>
</tbody>
</table>

Example No. 2. (Depreciation Adjustment):

Assume that a Plant was bought on Jan. 1, 1987 at a cost of Rs. 5,00,000. The estimated useful life of the plant was 10 years. On 1.1.1990 Plant of same type was of cost of Rs. 8,00,000 and on 31st December, 1990 of Rs. 10,00,000. Assuming that there is no change in estimated useful life, the amount of depreciation for 1990 would be as under:

The depreciation provision under C.C.A. for the expired 3 years as on 1.1.1990 = 3/10x8,00,000=Rs. 2,40,000.

- The depreciation provision under C.C.A. for the expired 3 years as on 1.1.1990 = 3/10x8,00,000=Rs. 2,40,000.
Current value of the Plant as on 31.12.1990 is Rs. 10,00,000. Expired portion of the service potential of the Plant as on 31.12.1990 = 4 years (i.e. Jan. 1990-Jan. 1987).

Therefore, depreciation provision under CCA =

\[ 1000000 \times \frac{4}{10} = \text{Rs. 400000} \]

Amount of depreciation to be charged for 1990 will be:

\[ [(\text{Rs. 8,00,000} + \text{Rs. 10,00,000}) - 2] \times \frac{1}{10} = \text{Rs. 90000} \]

So, backlog will be charged

\[ = (\text{Rs. 400000} - \text{Rs. 240000}) - \text{Rs. 90000} = \text{Rs. 70000} \]

The backlog of depreciation is charged when the depreciable assets are converted in C.C. The backlog depreciation is debited to the 'Revaluation Reserve A/c' and is set off against the gain on revaluation of the asset which is credited to Revaluation Account.

**Advantages of Current Cost Accounting:**

The advocates of value of accounting were convinced that their methods were superior from theoretical as well as practical stand points. Practically, accounting for changes in the values both specific and general of the productive assets of firm, and retaining the familiar monetary unit of measure, addressed the only real concern of any consequence.
The statements are interpretable in the sense that the values often assumed by the user of historical cost statement are approximate to the assets. Current replacement value accounting or CCA provides the closer approximation of real income because revenues are related to costs in common rupees. Moreover, the income is not contaminated by changes in price level since these are excluded and set up in capital maintenance accounts.

Current values would take into account changing in both general and specific price upon balance sheet items of all the firms. No additional price changes are relevant in depicting the impact of inflation upon the productive parts of entities. Replacement cost would recognise the affects of changes in technology and competition as well as industry. Paculiarities were ignored by other methods of accounting. Ownership of modern technologically efficient plant and equipments of adequate scale represent an inflationary hedge and a competitive edge. Moreover, replacement value accounting would correct the prostitution of balance sheets by those firms using LEFO cost inventories. Comparability would be improved while retaining the benefits of matching current cost and revenues on income statements.
Many of the dilemmas concerning what should or should not be reported as operating profit would disappear since all gains would be disclosed. In all cases, presentation of all gains and losses would enable the users to assess the performance of a firm or a group of firms using the measures considered to be most appropriate in the given circumstances.

C-value accounting methods are considered to be much more useful tools for decision making purposes, internally and externally. Management is furnished routinely with the data that serve to protect the capital of the firm from involuntary diminution. The development of fiscally sound dividend policies would not only be enhanced but should be better understood by third parties. Value accounting method is future oriented and provides a more realistic basis for the development of pricing policies and strategies. All users would get better economic evaluations. "However, there appears to be an emerging consensus that, in the majority of inflationary situations current value data represent a superior basis for the estimation of future cash flows (Scott, 1978).

Disadvantages of C.C.A.:
"Difficult to praise and easy to criticise" applies in the case of current cost accounting also.
The criticisers say that CCA does not reflect the change in PP. Value was an elusive concept to most individuals but particularly so to accountants. All in all, subjectivity generated a cloud enshrouding the whole of value accounting. People also said that value accounting was not really a proposal to account for inflation, but rather a rejection of the historical cost model regardless of the degree or absence of inflation.

Anthony (1976) has demonstrated that recovery of historical costs plus costs of capital will produce a steady-state company in terms of inflation as long as selling prices are based upon historical costs. The amounts reported for most non-monetary assets in balance sheets are unsound, if not misleading. Several fallacies may be represented. Emphasis is placed upon current replacement values or costs. For items with rapid turnovers that emphasis seems to be appropriate. For longer lived items to be replaced in the distant future, the approach does not seem logical. Some say that management are free to use the assets entrusted to their care as much as they please, but one notion that they cannot do is to acquire them again.
The Value Accounting, represented by some critics, is a complete departure from historical costs and for the foreseeable future. Two sets of records would be necessary in order to satisfy legal and tax requirements. It is not for small business units. It will also be impracticable for large, complex companies and multinations. Expertise is also not available with every company. In India it is the main problem of implementation of CCA. Some fear that Audit-cost would increase by using CCA.

In spite of these above mentioned facts, current cost Accounting is used in many countries like U.K., Netherlands, America, India and Brazil. The adoption of value-accounting would eliminate some of the nonsense and much of the mechanical problems associated with the translation of foreign currencies under FABS-4 (Statement of Financial Accounting Standard No. 8, 1975). Miller (1980) said that although value accounting may be defended in the sense that it is theoretically more useful than other methods, it simply is not practicable.

Inflation Accounting in India

(1) Accounting Standards and Inflation-Accounting:

The Accounting Standard-1 (AS-1) was issued by ASB on 'Disclosure of Accounting Policies'. This
standard explains how the financial-statements should be the standard says that 'disclosure of significant presented policies being followed is necessary if the view presented is to be properly appreciated (Para-2). The para-14 of the AS-1 mentions the areas in which different accounting policies may be adopted by different enterprises by the examples. But the example of "Replacement/Current Cost-Accounting has not been mentioned. So, AS-1 has not mentioned inflation-accounting in any manner.

It appears from the para-24 of AS-1 that if price-level changes are adjusted in the financial-statements then it should be shown in the Report because the para says, "All significant accounting policies adopted in the preparation and presentation of financial-statements should be disclosed." We get similar ideas in para 26.

AS-2, para 24, speaks about the valuation of inventories. It says that, subject to the exception stated in Para 29.1 to 29.4 inventories should be valued at lower of the historical cost and net realisable value. There is no place for inflation-adjustment in this standard. Further, AS-6 pertaining to "Depreciation-Accounting" is not distinct in the sense that its para-26 leaves the reader in doubt as it is not
clear whether it speaks for price-level changes or not. The para is as such given below:

"Where the historical cost of a depreciable asset has undergone a change due to increase or decrease in long term liability on account of exchange-fluctuations price-adjustments, changes in duties or similar factors, the depreciation on the revised unamortised depreciable amount should be provided prospectively over the residual useful life of the asset."

So, the words 'price-adjustments and exchange-fluctuations' do not present a clear picture. To some extent, para 39(iii) of the Accounting-Standard-10 for "Accounting for Fixed-Assets" clarifies the picture. This para says the financial statements should disclose:

"Revalued amount substituted for historical cost of fixed assets, the method adopted to compute the revalued amounts, the nature of indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed-assets are stated at revalued amounts".
This standard allows for the adjustment of price-level changes' in disguise and the same should be disclosed in the financial-statements. By going through the standards provided by Accounting Standards Board of India ASB (under the umbrella of ICAI) a partial clarification comes-up regarding price-level-changes-adjustments in the financial-statements at the time of disclosure.

As far as accounting standards are concerned, there is no clear-cut guidance or suggestion or standard for inflation-accounting in India. Do far the Companies, viz. Steel Authority of India Limited (SAIL) and Cement Corporation of India (C.C.I.), using Current-Cost Accounts in their Annual-Reports generally adopt the basis or recommendations given by Accounting Standards Committee of U.K. contained in the Statement of Standard Accounting practice on Current Cost-Accounting (SSAP-16) and guidelines issued by Institute of Chartered-Accountants of India. SSAP-16 is followed by many companies in India, therefore, it is mentioned below in short SSAP-16.

The Accounting Standards Committee (U.K.), established in 1969, pronounced the Statement Showing Accounting Practices No.16 in 1980. It is also known as 'Standard 16 (1980)'. This standard requires that larger companies should publish inflation-adjusted
figures either as a supplementary statement or as a part of the main accounts. The standard has recommended the C.C.A. to make the adjustments in financial statements. Appreciation on revaluation is credited to current cost reserves. The following adjustments may be made:

(1) Depreciation is increased proportionate to the increase of value of depreciable asset.

(ii) 'Cost of sales' is also adjusted. In Indian Companies, like C.C.I. and SAIL, the cost of sales is adjusted by bringing the opening and closing stock to a common average stock price, by averaging method based on indices published by RBI and revised cost of sales is compared with the historical cost to arrive at the cost of sales adjustment.

(iii) Monetary working Capital Adjustment is also made like the adjustment cost of sales. In India, the same principle is used.

(iv) 'Gearing Adjustment' is made in respect of the impact of price-change (additional depreciation, cost of sales adjustment and monetary working capital adjustment). It is calculated as the proportion, which the long-term borrowing bears to the sum of long term borrowing and shareholders equity.
Most of the companies in India and England adhere to this standard. The Institute of Chartered Accountants also recommended that the Inflation Accounting should be adopted by Indian companies. In 1982, the Institute published a 'Guideline Note on Accounting for Changing Prices.' The recommendations advanced by ICAI are practised by these companies who prepare 'Current Cost Accounts.' The recommendations are given below:

(i) The enterprises, particularly the large units, may develop the necessary system to prepare and present the Current Cost Accounts.

(ii) Current Cost Accounting method has been recommended by the ICAI. However, the introduction of a full fledged system of C.C.A. on a wide scale, in India will inevitably take some time.

(iii) Adequate data-base has not been developed for changing-prices so far. The indices published by Government of India can be adopted in a number of cases.
(iv) Considering the importance of the information regarding the impact of changing prices it is recommended that while the primary financial statements should continue to be prepared and presented on the historical cost basis, supplementary information reflecting the effects of changing prices may also be provided in the financial statements on a voluntary basis by big enterprises.

(v) The audit of adjusted accounts is voluntary for the organisations who use such accounting methods.

(vi) The Accounting for changing prices is useful for external-users and internal management. However, the supplementary information may be given in the Report in the period of rapid and violent fluctuations in prices. The areas in which such information is of great importance to management include investment decisions and allocation of resources, dividend policy, pricing policy, and divisional and overall corporate performance evaluation.
In United Kingdom, the reforms in Tax-Structure were introduced for Accounting for changing prices. In India it has not been provided for still price-level changes accounting would be useful for generating relevant information for internal and external decision-making.

**Income Tax Act and Price Level Adjustment:**

In India, the Income Tax is levied on the profits of Business and Profession computed on the basis of Historical Costs. The depreciation is allowed to charge only on written-down-value of the asset. The rates given in Part-I of Appendix-I of the Income Tax Rules, 1962 are allowed for depreciation charge on different types of assets, but the depreciation on "adjusted-values has no place in India's Income Tax Act, 1961."

The tax on 'Capital-Gains' has attracted a little bit attention of the government. Recently Dr. Man Mohan Singh (Finance Minister of India) has given some consideration to the inflation and its adjustment at the time of sale of the capital asset and income taxes on the capital gain under-section 48(2) of the Income Tax Act.
Company Law and Price Level Adjustments:

The Company organisations in India follow the mercantile system of accounting. The Companies Act requires every company to keep proper books of accounts relating to its transactions and the make the greatest possible disclosure of its financial position in the published accounts, so that an intelligent appraisal of its state of affairs may be made. The Companies Act, 1956 provides that every company, public or private, must keep proper books of accounts with respect to receipts expenditure, sales and purchases, assets and liabilities etc.

The Profit & Loss Account and the Balance-Sheet of a company should be according to the requirements given under-section 209, 210, 211 and 212 of the Form and contents of Balance-Sheet and Profit & Loss Accounts. The Balance-Sheet and the Profit and Loss Account must be in the forms set-out in Part-I and II of Schedule-VI of the Companies Act respectively or as near thereto as circumstances permit or in such other form as may be approved by the Central Government. But there is no explanation about Inflation-Accounting. However, International Accounting Standard title "International to be
"Disclosed in Financial Statements" has set-out certain minimum disclosures.

Section 211 further explains that the Balance-Sheet of a Company must give a true and fair view of the state of affairs - assets and liabilities of the company as the end of the 'financial year.' Similarly, the Profit & Loss Account must also give a true and fair view of profit & loss of the company for the 'financial year.' 'Window Dressing,' i.e. showing a position better than it actually is or the other way creating secret reserve - would be contrary to the spirit of law.

The legal frame-work given in Companies Act, 1956 as well as Income Tax Act, 1961, do not having any provision the adjustment of price level changing.

Inspite of the fact that the Law does not permit the adjustment of price level changes, even than some big companies in India give the Current Cost Accounting in their Annual Reports. To some extent the Companies Act permits revaluation of assets. In essence, it may be said that to make 'Inflation-Accounting' popular and practicable in India, there is necessity of amendmends in Company Law and Income Tax Act.