ACCOUNTING FOR CHANGING PRICES

NWANEKE NNEKA JULIET

16/SMS02/042

INTERNATIONAL ACCOUNTING ACC406

**Summary of Accounting for Changing Prices.**

Accounting for changing prices is a system of maintaining accounts in which all items in financial statements are recorded at current values. It is also called inflation accounting; Prices do not remain constant over a period of time. They tend to change due to various economic, social or political factors. Changes in the price levels cause two types of economic conditions, inflation and deflation. Inflation may be defined as a period of general increase in the prices of factors of production while deflation may fall in the general price level. These changes in the price levels lead to inaccurate presentation of financial statements which otherwise are prepared to present a true and fair view of the company’s financial health. This is so because the financial statements are prepared on historical costs on the assumption that the unit of account. This system of accounting ascertains profit or loss and presents financial position of the business on the basis of current prices. Inflation happens when the prices of goods and services increases in an economy. For example, if the inflation rate for a gallon of gas is 4% per year, then gas prices will be 4% higher the following year. Also, inflation increases the amount of external financing required and the company's debt-to-equity ratio when measured on its historical cost financial statements.

**Impact of inflation on financial statement**

Financial statement of any organization contains a summarized information of its financial affairs organized systematically over a period of time the vital and crucial importance of financial statement is not only to the member of organization but also to third parties dealing with the organization. It has been realized for many years that financial account prepared based on historical costs can be misleading in time of changing price that is inflation. During economic crisis inflation results to distortion of financial statement since the accounting measuring rod of value of money and accounting profits is also measured in monetary terms the historical values at which assets and liabilities are sated in the balance sheet becomes unrealistic in times of inflation. For instance, if divided payment are made on the basis of historical cost profit it might lead to servers under capitalization of the organization concepts of inflation.

**Purchasing power gains and losses**

Purchasing power gains and losses is an increase or decrease in how much consumers can buy with a given amount of money. Consumers gain purchasing power when prices decrease, and lose purchasing power when prices increase.

**Methods of accounting for changing prices**

Two solutions have been developed to deal with the distortion caused by historical cost accounting in a period of changing prices which are:

* General purchasing power(GPP)accounting
* Current cost(CC)accounting

General purchasing power accounting makes adjustments to the historical costs of assets to update for changes in the purchasing power of the currency.

Current cost accounting is the preparation of financial statements on the current values of individual items and not on the historical or original cost. Inventories are valued in the balance sheet at their current replacement costs on the date of the balance sheet.