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COURSE: INTERNATIONAL ACCOUNTING

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**ACCOUNTING FOR CHANGING PRICES (INFLATION ACCOUNTING)**

Inflation accounting will occur when the prices of items are affected by inflation in a country. These items are normally recorded at historical cost price but with the effect of an inflation, such item’s price will fluctuate either upwards or downwards. This will affect the figures in the statement of financial position. The can either be overstated or understated. To curb these changes, it would be needed to account for inflation. If the changes in the prices of assets are ignored, it can lead to a negative impact on the company’s ability to borrow caused by an understated asset value or more taxes being paid to the government because of an overstated income.

Historical cost accounting also overlooks the purchasing power gains and losses that arise from holding monetary assets (cash and receivables) and monetary liabilities (payables) during a time of inflation. Holding cash and receivables during inflation results in a purchasing power loss, whereas holding payables during inflation results in a purchasing power gain. A net purchasing power gain will result when an entity maintains monetary liabilities more than monetary assets during inflation, and a net purchasing power loss will result when the opposite situation exists.

There are two methods to account for inflation and changing prices. They are account for changes in general price level and account for specific price changes. The general price level adjusts the historical cost of assets to update for changes in the purchasing power of the currency. It is also known as general purchasing power accounting (GPP). Under GPP accounting, non-monetary assets and liabilities, stockholders’ equity, and all income statement items are restated from the GPI at the transaction date to the GPI at the end of the current period.

Account for specific changes updates the values of assets from historical cost to the current cost to replace those assets. This is also known as current replacement cost or current cost accounting. Under CC accounting, historical costs of nonmonetary assets are replaced with current replacement costs and expenses are based on these current costs.