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MARTIC NUMBER: 16/SMS02/005

COURSE TITLE: INTERNATIONAL ACCOUNTING

COURSE CODE: ACC 406

ASSIGNMENT TITLE: ACCOUNTING FOR CHANGING PRICES

**SUMMARY OF ACCOUNTING FOR CHANGING PRICES**

Inflation is said to be present in an economy when the general prices of goods and services increases which is usually measured my economists by determining the current price of an item, goods and services and then comparing it with the prices it was at an earlier time. During a period of inflation, assets are reported on the statement of financial position are at historic cost and hence they are understated of their current value which will lead to understated expenses which in turn will overstate the net income and retained earnings. Understated asset values could have a negative impact on the company’s ability to borrow because the collateral will also be understated. Over stated income definitely means that the company will pay more taxes to the government and also making the shareholders demand for a higher amount of dividends. The understatement of assets and overstatement of income will distort comparisons across companies. In addition to this we need to understand the concepts of purchasing power and losses during a period of inflation. Holding cash and receivables during inflation results in a purchasing power loss, on the other hand holding payables during inflation results in a purchasing power gain.

**Methods of Accounting for Changing Prices**

There are two methods that have been developed to account for change in prices. The first method is the general purchasing power (GPP). This method is used to account for changes in the general price level by making adjustments to the historical costs of assets to update for changes in the purchasing power of the currency. The second method is the current cost method (CC) or current replacement cost method (CRC). This method accounts for specific price changes by updating the values of assets from historical cost to the current cost to replace the assets.

In addition, the application of the three methods of asset valuation (historical cost, general purchasing power and current cost methods) will definitely results in a different amount of net income which relates to a specific concept of capital maintenance. Thus historical cost is the amount that can be distributed to owners while maintaining the nominal amount of contributed capital at the beginning of the year.