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**MATRIC NUMBER: 16/SMS02/003**

**COURSE CODE: ACC406**

**COURSE TITLE: INTERNATIONAL ACCOUNTING**

**ASSIGNMENT: SUMMARY OF ACCOUNTING FOR CHANGING PRICES**

Prices of most assets fluctuate, often increasing. Reporting assets on the Statement of Financial Position at their historical cost during a period of price changes can make the Statement of Financial Position information irrelevant. When the prices of goods and services in an economy increase in general, we say that inflation has occurred. Economists often measure inflation by determining the current price for a “basket” of goods and services and then compare the current price with the price for the same basket of goods and services at an earlier time, For example, if a basket of goods and services costs N140 at the end of Year 1 and the same basket costs N152 at the end of Year 2, then inflation in Year 2 was 8 percent ([N162 − N150]/N150).

**Impact of Inflation on Financial Statements**

During a period of inflation, assets reported on the Statement of Financial Position at historical cost are understated in terms of their current value.

Ignoring changes in the prices of assets can lead to a number of problems such as:

1. Understated asset values could have a negative impact on a company’s ability to borrow, because the collateral is understated. Understated asset values also can invite a hostile takeover to the extent that the current market price of a company’s stock does not reflect the current value of assets.
2. Overstated income results in more taxes being paid to the government than would otherwise be paid and could lead stockholders to demand a higher level of dividend than would otherwise be expected.
3. To the extent that companies are exposed to different rates of inflation, the understatement of assets and overstatement of income will differ across companies; this can distort comparisons across companies. Because inflation rates tend to vary across countries, comparisons made by a parent company across its subsidiaries located in different countries can be distorted.

**Purchasing Power Gains and Losses**

historical cost accounting ignores the purchasing power gains and losses that arise from holding monetary assets and monetary liabilities during a period 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.

**Methods of Accounting for Changing Prices**

1. **Account for changes in the general price level**: This approach makes adjustments to the historical costs of assets to update for changes in the purchasing power of the currency and therefore is referred to as GENERAL PRICE-LEVEL-ADJUSTED HISTORICAL COST ACCOUNTING or, GENERAL PURCHASING POWER ACCOUNTING

Under GPP accounting, nonmonetary 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. Non-current assets and intangible assets and the related depreciation and amortization would also be restated for changes in general purchasing power.

1. **Account for specific price changes**: by updating the values of assets from historical cost to the current cost to replace those assets. This is known as CURRENT REPLACEMENT COST or, CURRENT COST ACCOUNTING. In addition to adjusting asset values for changes in the general price level and determining expenses from GPLAHC amounts, GPP accounting also requires that purchasing power gains and losses be included in the determination of net income. Maintaining the purchasing power of equity does not necessarily ensure that the company is able to continue to operate at its existing level of capacity, because the prices of specific goods and services purchased by an individual company do not necessarily increase at the rate of average inflation.