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MATRIC NUMBER: 16/SMS02/029

SUMMARY ON ACCOUNTING FOR CHANGING PRICES

**Inflation Accounting**

Accounts receivable shall be measured at the total amount estimated to be paid in the future; short-term purchases shall be measured at any expense or present market value; inventory shall be held at a reduced cost or market value; and land, plant, and facilities shall be reported at a less accrued rate. Most asset prices are fluctuating, frequently increasing. Most asset prices are fluctuating, frequently 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. Economists also calculate inflation by increasing the current price for a "basket" of goods and services and then earlier comparing the current price to the same basket of goods and services. For example, if at the end of Year 1 a basket of products and services costs N120 and the same basket costs N132 at the end of Year 2, then Year 2 inflation was 10 per cent ([N132 − N120]/N120). Not all goods and services raise costs by 10 percent while the inflation rate is 10 percent. The price of a modern computer could rise by 15 per cent, the price of component parts could increase by 12 per cent, the price of Janitorial services could increase by 5 per cent, and the price of raw materials could only decline by 4 per cent. These are measures of changes in specific prices.

**Impact of Inflation on Financial Statements**

Getting understated assets results in understated expenditures (especially depreciation and cost of sales goods), resulting in over established net profit and over established retained earnings in effect. Ignoring shifts in asset prices can lead to problems like:

1. Having an adverse effect on the borrowing ability of a corporation due to devalued (collateral) asset values;
2. Inflated profits results in more taxes being charged to the government than would actually be collected and could cause stockholders to claim a higher dividend price than anticipated;
3. And lastly, the degree to which companies are subject to varying inflation rates, asset underestimate and profit overstatement may vary between companies; this may skew similarities between firms.

Keeping cash and receivables during inflation results in a loss in buying power, thus keeping payable during inflation leads to an increase in purchasing power.

The increase of price trend requires two solutions in a cycle of rising costs, triggered by historical expense (HC) accounting.

The first solution is to compensate for fluctuations in the general market level where this method makes revisions to the historical cost of assets to correct for improvements in the buying value of the currency and is thus referred to as accounting for general price-level-adjusted historical costs (GPLAHC), or, more simply, general purchasing power (GPP). Within GPP accounting, non-monetary assets and liabilities, interest of stockholders and all aspects of income statement are restated by the GPI at the close of the present year at the settlement date to the GPI.

The other approach is to compensate for real market adjustments by changing the asset prices to adjust those properties from past costs to the present costs. This is known as current replacement cost (CRC) or, simply, current cost (CC) accounting. This contrast to updating asset prices for adjustments in the average market cost and calculating costs from GPLAHC numbers, GPP accounting also mandates that profits and reductions of purchasing power be used in net profit determinations.