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**SUMMARY ON TE TOPIC ACCOUNTING FOR CHANGING PRICES**

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.
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.

**Purchasing Power Gains and Losses**

Ignoring changes in the values of nonmonetary assets, historical cost accounting also ignores the purchasing power gains and losses that arise from holding monetary assets which are cash and receivables and monetary liabilities that is payables during a period of inflation. Holding cash and receivables during inflation will results in a purchasing power loss, whereas holding payables during inflation will results in a purchasing power gain.

**Methods of Accounting for Changing Prices**

There are three methods in accounting for changing prices which are:

1. **Historical Cost(HC):**

This method is used during a period of inflation, assets reported on the Statement of Financial Position at historical cost are understated in terms of their current value.

1. **General Purchasing Power(GPP):**

This method is developed to deal with the distortions caused by historical cost (HC) accounting in a period of changing prices. The method is to 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. 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.

1. **Current Cost Accounting(CC):**

This method is to 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, simply, current cost (CC) accounting. 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.