**Inflation accounting**

General inflation rate reflects the decrease in the purchasing power of a currency. Conventional accounting mixes attributes that are reflected in the asset section of the statement of financial position. During inflation, not all goods and services increase in price at the same rate even when there is an average inflation. Price of some assets may increase slight higher than others. Hence, reporting assets on the statement of financial position at historical cost during inflation might make the statement of financial position irrelevant.

**Impact of inflation on financial statements**

Historical costs are understated in terms of their current value during inflation period. If the changes in prices are ignored, some problems may arise. Such problems may be; understated asset values which lead to negative impact on a company’s ability to borrow; overstated income results in more taxes being paid and stockholders demanding a higher level of dividend than expected;

**Purchasing power gains and losses**

Ignoring changes in the value of nonmonetary assets, HC will ignore the purchasing power gains and losses that come from holding monetary assets and monetary liabilities during inflation.

**Methods of accounting for changing prices**

The following are ways of accounting for changing prices

* Historical cost
* General purchasing power accounting (GPP)
* Current replacement cost.

**Net income and capital maintenance**

Applying any of the methods will result in different amount of net income. This is because each method measures their net income with a different concept of capital maintenance.

**General Purchasing Power (GPP) Accounting**

Here, nommonetary assets and liabilities, stockholders’ equity, and income statements are restated form the GPI at the transaction date to the GPI at the end of the current period. Assuming inventory acquired beginning of the year when the GPI is 100 and the GPI at the end of the year is 120, the inventory is restated using the ratio 120/100. Non-current assets and intangible assets and their related depreciation and amortization would also be restated for changes in general purchasing power.

**Current Cost (CC) Accounting**

This is applied to determine the amount of income that can be shared to owners and keeping the company’s productive capacity. Here, historical costs of nonmonetary assets are replaced with current replacement costs and expenses are based on these costs.

If historical cost accounting is used as the basis for taxation and dividend distribution, probability that the company will not be as well of at the end of the year in productive capacity and purchasing power as it was in the beginning of the year is high.