46. Impact of Inflation on Financial Statement

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Introduction. Domestic and foreign experience shows the dependence of the results of accounting from such economic factors as inflation. The need of coverage of this aspect of accounting in Ukraine is primarily due to significant price changes in the economy of our state.

Resources and methods. Accounting in terms of inflation was studied by such leading scientists as S. I. Adamenko, A. K. Gogolev, C. N. Evseev, G. G. Kireitsev, G. E. Kovalenko, V. C. Kovaleva, I. S. Karapetkov, A. S. Lugov, D. Middleton, A. Miller, M. C. Novikova, V. F. Paliy, V. Parkhomenko, S. Petkova, C. I. Puchkova, M. Kharchenko, I. Yaroshchuk. Scientists pay attention to a number of issues associated with the problems of accounting in terms of inflation. However, this problem remains insufficiently studied and requires further in-depth research.

Results. The persistent inflation experienced by many industrialised nations during the 1970's caused widespread commitment to Historical Cost. In most countries, primary financial statements are prepared on the historical cost basis of accounting without regard either to changes in the general level of prices.

General price level changes in financial reporting creates distortions in financial statements such as: many of the historical numbers appearing on financial statements are not economically relevant because prices have changed since they were incurred; since the numbers on financial statements represent monetary units expended at different points of time and, in turn, embody different amounts of purchasing power, they are simply not additive; the asset values for inventory, equipment and plant do not reflect their economic value to the business; future earnings are not easily projected from historical earnings; future capital needs are difficult to forecast and may lead to increased leverage, which increases the risk to the business; when real economic performance is distorted, these distortions lead to social and political consequences that damage businesses.

Inflation accounting, a range of accounting systems designed to correct problems arising from historical cost accounting in the presence of inflation, is a solution to these problems. This type of accounting is used in countries experiencing high inflation or hyperinflation [3]. Unless adjustments are made, users of accounts may be seriously misled about the value and profitability of a business and about what may be suitable levels of dividends, wages or prices. If adjustments are not made to correct for changing prices, some expenses based on past costs will be matched against revenues based on current sales prices. Adjustments need to be made for the benefit of the users of financial statements.

The IASB have struggled in finding a solution to deal with inflation. This led to the issue of IAS 15 Information Reflecting the Effects of Changing Prices which required companies to restate the HCA accounts using either a general price index or replacement costs with adjustments for depreciation, cost of sales and monetary items. IAS15 was made optional 1989 and as part of IASB's Improvements Project the standard was withdrawn in 2005 [2]. IAS 29 aims to overcome the boundaries of historical cost financial reporting in hyperinflationary environments.

The principle in IAS 29 is that the financial statements of an entity that reports in the currency of a hyperinflationary economy should be stated in terms of the measuring unit current at the balance sheet date. Comparative figures for previous periods should be restated into the same current measuring unit. Restatements are made by applying a general price index. Items such as monetary items that are already stated at the measuring unit at the balance sheet date are not restated. Other items are restated based on the change in the general price index between the date those items were acquired or incurred and the balance sheet date.

Conclusions. The Standard does not establish a total rate at which hyperinflation is to arise but allows ruling as to when restatement of financial statements becomes necessary. Nevertheless the restatement of historical cost financial statements in terms of IAS 29 does not indicate the abolishment of the historical cost model; it simply tries to correct the problems. PricewaterhouseCoopers: said "Inflation-adjusted financial statements are an extension to, not a departure from, historical cost accounting."

References

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