ACCOUNTING IN AN INFLATIONARY ENVIRONMENT

STUDIES IN FINANCE AND ACCOUNTING

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Accounting in an Inflationary Environment

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In memory of Maud E. Scapens

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General Editors' Preface

The last few years have been very exciting for research in finance and accounting. An enormous amount has happened, and in many cases traditional thinking and traditional solutions have been completely overthrown. At the same time it is quite clear that research into the theory and, perhaps even more important, into British empirical evidence will continue to accumulate rapidly. While this is fine for the researcher in his detailed specialist world, it is not so good for the student who wants to acquire a relatively straightforward but up-to-date overview of the subject.

The 'Macmillan Studies in Finance and Accounting' set out to provide short, reasonably critical surveys of the developments within the various specialist areas of business finance and accounting. The emphasis in each study is upon recent work, but each topic will generally be placed in a historical context so that the reader may see the logical development of thought through time. Selected bibliographies are provided to guide readers to more extensive works. Each study aims at a brief treatment of the salient problems in order to avoid clouding the issues in too much detailed argument.

Unfortunately it is inevitable that in a few areas the level of mathematics will be rather near the limit for some students. This is because the rigorous methods of statistics, econometrics and mathematical economics have made a considerable contribution to the research achievements in the subject. Thus, although all the authors in the series have tried hard to make their presentation as lucid as possible, there is a point beyond which mathematical arguments cannot be explained non-mathematically except at a superficial level. Nevertheless intuition can go a long way and many students, even with very little mathematical background, have found that the intrinsic

fascination of the subject more than compensates for occasional difficulty.

M. J. Barron
D. W. Pearce

Preface

The 1970s have brought rapid change to the accountancy profession in the United Kingdom and other countries. Many exposure drafts and statements of standard accounting practice have been published. The subject which has probably given rise to most discussion is the treatment of inflation. This decade may witness the end of the system of historic-cost accounting as the primary means of reporting financial information. The high rates of inflation in many Western countries in recent years have led to a serious reappraisal of the usefulness of historic-cost data. In general, this reappraisal has led to the conclusion that historic-cost accounting has serious shortcomings, particularly in a period of inflation.

The initial attempts to resolve these shortcomings involved the use of purchasing-power adjustments to remove the effects of inflation from historic-cost measurements. However, this approach was severely criticised by many accountants, businessmen and others. In consequence a more fundamental approach was sought. At the time of writing it is expected that historic-cost accounting will be replaced in the near future by a method of current-cost accounting.

The Accounting Standards Committee's *Exposure Draft No. 18* has been published, but the controversy has not ceased. The draft sets out the proposed standard for the application of the method of current-cost accounting advocated by the Sandilands Committee. Several aspects of *Exposure Draft No. 18* have attracted criticism and a number of prominent accountants and businessmen are pressing for additional time to prepare for the implementation of current-cost accounting. None the less it appears likely that current-cost accounting will soon replace historic-cost accounting in the United Kingdom.

The objective of this book is to explain the developments which

have taken place in recent years in the field of accounting in an inflationary environment. The system of current-cost accounting is discussed and, in addition, the prior developments (such as price-level accounting) are examined. In this way it is hoped that the present position will be put into perspective. The implications for financial and management accounting are considered.

It will be assumed that the reader has a basic knowledge of financial and management accounting, but an understanding of particular accounting procedures is not essential. This book is not a detailed manual of current-cost accounting. The principles and concepts of methods of accounting in an inflationary environment (including current-cost accounting) are discussed and illustrated by simple examples. The book is intended to explain the conceptual nature of recent developments in this area to both students and practitioners of accounting.

In conclusion I would like to express my thanks to Mr Roy Cromer and his Word Processing Department at the Ohio State University for the preparation of the typed draft and to Miss Debbie Jameson for her painstaking work in typing my revisions. My thanks are also due to my wife, Maureen, for her encouragement and her help with the arduous task of checking my manuscript.

Manchester University
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