

Subject-Advanced Corporate  
Accounting  
Topic-Current Purchasing Power  
Method of Inflation Accounting

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# INTRODUCTION

This method is used under price level accounting. Price level accounting is a technique by which financial statements are restated to show changes in general price level. Under current purchasing power method, all items of financial statements are to be restated as per changes in price level. Approved price level index is used to convert the values of various items of profit and loss statement and balance sheet.

# Steps for CPP method

1) **Conversion factor**:-This require the restatement of historical figures as disclosed in financial statements at current purchasing power of money. The formula for conversion factor is as:-

$$\text{Conversion factor} = \frac{\text{price index at conversion date}}{\text{price index at item arose date}}$$

For example: company purchased a building on 1 January, 2012 for ₹ 500,000. The price index on that date was 100. And now company want to restate the value of building when price index stood at 200 on 1<sup>st</sup> January, 2020, the the conversion factor is as:

$$\text{Conversion factor} = \frac{200}{100} = 2$$

Value of building = 500,000 x 2 = 10,00,000.

**2) Mid period conversion:-** There are many items which occurred throughout the year, which required to be restated as per averaged index number. These items are purchase, sales, expenses etc. the average index is calculated by using the following formula:

$$\text{Average index number} = \frac{\text{Beginning index number} + \text{Index number at end}}{2}$$

**3) Monetary items:-** These are that assets and liabilities whose amount are to be remained same in terms of monetary units. Closing balance of such items need no conversion. Example of monetary items are debtors, creditors, outstanding expenses, B/R, B/P, prepaid expense, loans etc.

**4) Non monetary items:-** These are the assets and liabilities that cannot remained same in terms of monetary units. For example- building, land, machinery, stock etc.

**5) Gain or loss on monetary items:-** Due to change in purchasing power of money a gain or loss arise on monetary items because a company receive or pay fixed amount on monetary items. Holding of monetary assets result in monetary loss and holding of monetary liabilities result in monetary gain.

**6)Cost of goods sold and inventories:-**Under this method, the cost of goods sold and inventories depend on the methods adopted for issue of materials such as FIFO method or LIFO method.

Under FIFO method, cost of goods sold include entire opening stock + purchases – closing stock. Whereas, closing stock consist of current purchases.

Under LIFO method, cost of goods sold include current purchases only. If current purchases are less than cost of goods sold than part of opening stock can also become part of cost of goods sold. Whereas, closing stock consist of purchase made in past years.

**7) Determine the profit:-** Under CPP, the profit can be determine by two ways.

**(a) Conversion of income method:-** This include conversion of profit and loss statement as per CPP method by considering following points:-

- (i) Sales and operating expenses are converted at average index.
- (ii) Fixed assets are converted on the basis of index on which such asset was purchased.
- (iii) Cost of goods sold as per LIFO or FIFO method.
- (iv) Taxes and dividend are on the index number present at the time of payment dates.
- (v) Gain or loss on monetary items also disclosed .

**(b) Net change method:-** Under this, closing balance sheet prepare under historical is restated . But monetary items are not to be converted. The difference between the two sides of balance sheet is treated as reserves. Alternatively, the equity share capital may not be converted and difference between balance sheet is treated as equity.

# Advantages of CPP method

- 1) Helps to calculate true ratios.
- 2) Show true financial position of the company.
- 3) Easy to operate.
- 4) Gives more real information to stakeholders.
- 5) Help to distinguish between monetary and non monetary items.

# Disadvantages of CPP method

- 1) Difficult to select proper index number.
- 2) Not suitable for proper replacement of assets.
- 3) Not suitable for taxation purpose.
- 4) Figures are not comparable.
- 5) Demerits of index number affects the accuracy of results.



**THANK YOU**