Inflation Accounting

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Inflation Accounting

Introduction:
The basic objective of Accounting is the preparation of financial statements is a way that they give a true and fair view of the operating results and the financial position of the business to its various users, namely investors, creditors, management, Government, trade unions, research institutions etc. These financial statements are prepared based on certain accounting concepts and conventions. The money measurement concept is a basic attribute of accounting.

The money measurement concept states that only those business transactions that are capable of being expressed in terms of money can be recovered in the books of account. It also assumes that the monetary unit used for recording the transaction is stable in nature. However, this is not true in practice as many countries, developed as well as developing, have been experiencing inflation of high magnitude in recent times. Inflation refers to state of continuous rise in prices. It brings downward changes in the purchasing power of monetary unit. Thus, financial statements prepared without taking into account the change in purchasing power of the monetary unit lose their significance. There is a demand that business enterprises should prepare inflation adjusted financial statements. The different ways through which financial accounts can be adjusted for changing prices is studied under the subject Inflation Accounting. Given that price changes can also be downward, it is more appropriately called Accounting for price level changes.

Methods of Accounting for price level changes:
There is no consensus on the method to be adopted for adjusting the financial statements for price level changes. Price level changes can be broadly classified into general price level changes and specific price changes. General Price changes reflect the overall increase or decrease in the value of monetary unit. The changes in wholesale price index (WPI) or the consumer price...
index (CPI) are examples of such price level changes. Specific price refer to changes in the price of a specific asset. It is important to note that the price of a particular asset may not follow the same trend as WPI or CPI. They are

1. Current Purchasing Power (CPP) method, based on changes in general price level changes
2. Current Cost Accounting (CCA) method, based on changes in prices of specific assets.

1. Current Purchasing Power method:

   a) Conversion Factor
   b) Calculation of Net Monetary Gain/Loss
   c) Impact of change in price level on Monetary Items
   d) Calculation of Monetary Gain/Loss
   e) Valuation of Inventory and Cost of goods sold

      i) FIFO
      ii) LIFO

   f) Fixed Assets and Depreciation
   g) Other Points

      i) Taxation
      ii) Interest on Debentures
      iii) Dividends
      iv) Capital

**Current Purchasing Power (CPP):**

CPP Method of inflation accounting seeks to use general purchasing power price of money rather than specific indices to convert the historical figures into relevant figures of purchasing power for the end of the period in review.

In simple terms, the conversion process of historical figures into CPP figures involves two steps:

- Multiplying the Historical Cost figures by the price index at the end of the period;
- Dividing the figures obtained in Step (i) above by the index which existed at the date of original transaction.

*Example:*

- **Historical Cost figures**
  - 1.1.85 - Fixed Assets - Rs. 2,00,000/-
  - Index on 1.1.85 - 120
  - Index on 31.12.87 - Date of review 150

- **Conversion** = \( \frac{2,00,000 \times 150}{120} = Rs. 2,50,000 \)
The conversion process is discussed below in following 3 sections:

   a. Balance Sheet at the beginning of the year;
   b. Profit and Loss a/c for the year and
   c. Balance sheet at the end of the year

a. Balance sheet at the beginning of the year:
For the sake of convenience, the Balance Sheet is viewed as comprising of 3 parts:

1. Monetary Assets;
2. Non-Monetary Asset and
3. Shareholders Fund

1. Monetary Assets:

They comprise of Debtors, cash, creditors etc. The CPP method assumes that the value of these assets on the Balance sheet date reflect the CPP as at the end of the previous year. These figures are converted into CPP figures as follows:

Index at the end
Historical Cost X -------------------------------
Index on the date of Balance Sheet

2. Non-Monetary Assets

These are discussed in 3 heads:

i. Fixed Assets
Index at the end
Historical Cost figures X -------------------------------
Index on the date of Acquisiton

   ii. Depreciation
Index at the end
Accumulated Depreciation X -------------------------------
Index on the date of Acquisition
If assets are acquired over a period of time, calculations would have to be made separately for each of the acquisition.

   iii. Stock
In converting Historical cost figures of stock, the first step is to identify the period during which the items in stock were purchased and then a price index representative of the price level during such period is identified.
iv. Shareholders Funds:
It is not possible to convert shareholders funds i.e. share capital + Accumulated Reserves on historic cost figures into CPP figure by multiplying with any specific index. It is arrived at by subtracting all liabilities at CPP from the assets both fixed and current at CPP.

b. Profit and Loss Account:
Discussed under four sections:

1. Stock at the beginning of the year
2. Transactions during the year
3. Depreciation written off for the year and
4. Loss of purchasing power during the year because of holding monetary assets.

1. Stock at the beginning of the year:
Same as discussed under Non-Monetary Assets.

2. Transactions during the year:
Normally the CPP assumes transactions occur evenly throughout the year. In such cases, average price index for the year is used. But in cases where the transactions occur unequally, it is necessary to use a weighted average index or to convert for eg. using each quarters transactions separately.

3. Depreciation written off for the year:
   First Step: Value assets on CPP basis
   Second Step: Apply rates of depreciation to cost of assets expressed in CPP terms.

4. Loss of purchasing power for holding net monetary assets:
   Step I: Loss on opening balance of net monetary assets i.e. Debtors + Cash Creditors
   (Index at the end / Index at the beginning of the year)
   Non Monetary Assets at the X -----------------------------------------------
   beginning of the year / Index at the beginning of the year

   Step II: Increase / Decrease in Net Monetary assets
   Net Monetary assets at beginning Net Monetary assets at the end of the year
   Step III: Loss on increase / Decrease in Net Monetary Assets
   (Index at the end / Average Index for the year)
   Figure in Step II X ---------------------------------------------------------------
   Average Index for the year
   Step IV: Add figure in Step I to figure in Step III
The above process of calculation assumes that the figure of net monetary assets at the end of the year comprises of 2 parts:

i. Opening balance of net monetary assets and 
ii. Increase / Decrease in Net Monetary assets during the year.

c. Balance Sheet at the end of the year:
Discussed under 3 heads:

i. Non-Monetary assets:
   a) Fixed Assets & Depreciation - Same treatment as in the case of opening balance sheet
   b) Stock Method adopted in Profit and Loss A/c
   ii. Monetary No need for conversion since monetary assets at the end of the year are already expressed in terms of CPP.
   iii. Shareholders funds = Assets(CPP) - Liabilities(CPP)

Illustration
The following data are available from the books of M/s Manaank Ltd as on 31st March 2003

<table>
<thead>
<tr>
<th>Particulars</th>
<th>1st April 2002</th>
<th>31st March 2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>3,500</td>
<td>4,500</td>
</tr>
<tr>
<td>Book Debts</td>
<td>25,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Creditors</td>
<td>18,000</td>
<td>22,000</td>
</tr>
<tr>
<td>Loan</td>
<td>40,000</td>
<td>40,000</td>
</tr>
</tbody>
</table>

You are required to work out the net monetary result of the company as at 31st March 2003, considering the following retail price index number.

1st April 2002: 240; 31st March 2003: 360;

Average Index for the year: 300

Solution:
Monetary Liabilities at the beginning of the year:
Creditors 18,000
Loan 40,000
58,000
CPP Value at the end of the year = $58,000 \times \text{Index at the end of the year}$
Index at the beginning of the year
= $58000 \times 360/240 = Rs. 87,000$

Increase in Monetary Liabilities during the year:
Creditors: $(22,000 - 18,000) = 4,000$
Loan: $(40,000 - 40,000) = 0$

CPP Value at the end of the year = $4,000 \times \text{Index at the end of the year}$
Average Index for the year
= $4,000 \times 36/300 = Rs. 4,800$

Thus, CPP value of Monetary Liabilities at the end of the year = $87,000 + 4,800 = Rs. 91,800$

(-) Actual value (as per HCA) at the end of the year = $22,000 + 40,000 = Rs. 62,000$

Monetary Gain on account of increase in Liabilities (A) = Rs. 29,800

Monetary Assets at the beginning of the year:
Cash $3,500$
Book Debts $25,000$

CPP value of above at the end of the year = $28,500 \times 36/240 = 42,750$

Increase in Monetary Assets during the year:
Cash: $4,500 - 3,500 = 1,000$
Book Debts: $30,000 - 25,000 = 5,000$

CPP value of Increase at the end of the year = $6,000 \times 360/300 = Rs. 7,200$

CPP Value of monetary Assets at the end of the year = $42,750 + 7,200 = Rs. 49,950$

(-) Actual value (as per HCA) at the end of the year = $4,500 + 30,000 = Rs. 34,500$

Thus, Monetary loss on account of increase in Assets (B) = Rs. 15,450

Net Monetary Gain = A - B = $29,800 - 15,450 = Rs. 14,350

Problem No. 1

Balance Sheet of Rama Co. on Historic cost figures:

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share holders</td>
<td>35,000</td>
<td>40,000</td>
<td>Fixed Assets</td>
<td>30,000</td>
<td>30,000</td>
</tr>
<tr>
<td>---------------</td>
<td>--------</td>
<td>--------</td>
<td>--------------</td>
<td>--------</td>
<td>--------</td>
</tr>
<tr>
<td>Equity</td>
<td></td>
<td></td>
<td>Less:</td>
<td>10,000</td>
<td>11,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Depreciation</td>
<td>20,000</td>
<td>19,000</td>
</tr>
<tr>
<td>Creditors</td>
<td>12,000</td>
<td>27,000</td>
<td>Stock</td>
<td>9,000</td>
<td>18,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Debtors</td>
<td>10,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Cash</td>
<td>8,000</td>
<td>5,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>47,000</td>
<td>67,000</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Profit and Loss a/c for year ended 31/12/76:
Rs.
Sales 40,000
Less: Cost of Sales 34,000
Depreciation 1,000 35,000
Profit 5,000

- a. Sales were made on credit
- b. Cash received from debtors Rs. 20,000/-
- c. Purchase of Stock on credit Rs. 43,000/-
- d. Cash payments to supplier Rs. 18,000/-
- e. Transactions assumed to have occurred evenly throughout the year.

General Price indexes were:

Year 31.12.59 31.12.75 31.12.76
Index 60 90 105

- ii. Prepare Profit and Loss a/c for year ended 31.12.76 in terms of CPP 31.12.76.

PART I Conversion of Opening Balance Sheet
Working Note:

1. Non Monetary Assets (Comprising of Fixed Assets and Stock)

   a. Fixed assets at 60 20000
   Closing Index 105 - 20000 x 105/60 = 35000
   b. Opening Stock 90 - 9000
Closing index 105 - 9000 x 105/90 = 10500
Since date of purchase of stock is not given, it is assumed to be purchased at the end of previous year and hence the closing
index of P.Y is considered.

2. Net Monetary Assets:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>HC</th>
<th>Conversion</th>
<th>CC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debtors</td>
<td>10,000</td>
<td>10,000 x 105/90</td>
<td>11667</td>
</tr>
<tr>
<td>Cash</td>
<td>8000</td>
<td>8000 x 105/90</td>
<td>9333</td>
</tr>
<tr>
<td></td>
<td>18000</td>
<td>21000</td>
<td></td>
</tr>
<tr>
<td>Creditors</td>
<td>12000</td>
<td>12000 x 105/90</td>
<td>14000</td>
</tr>
<tr>
<td></td>
<td>6000</td>
<td>7000</td>
<td></td>
</tr>
</tbody>
</table>

Opening Balance Sheet at CPP:

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
<th>Assets</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Capital (Balance figure)</td>
<td>52500</td>
<td>Fixed Assets</td>
<td>35000</td>
</tr>
<tr>
<td>Creditors</td>
<td>14000</td>
<td>Stock</td>
<td>10500</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Debtors</td>
<td>11667</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cash</td>
<td>9333</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>66500</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>66500</td>
</tr>
</tbody>
</table>

PART II Profit & Loss A/c

1. a. Sales Average Index = (Opening+Closing)/2 = (90+105)/2 = 97.5
b. Sales at CPP = 40000 x 105/97.5 = 43077

2. Cost of the goods sold:
a. cost of the goods sold = opening stock+purchases-closing stock
34,000 = 9000+ purchases-closing stock
Purchases = 43,000
b. opening stock CPP WN1b Rs. 10500
c. Purchases at CPP = 43000 x 105/97.5 = 46308
d. Closing stock at CPP Since the date of purchase of stock and the relevant index is not given. It is assumed that
closing stock is out of goods purchased during the year and is hence converted with reference to Average index =
18000 x 105/97.5 = 19385
e. Cost of goods sold at CPP= Opening+Purchases-closing stock = 10500+46308-19385 = 37423 at CPP

3. Depreciation at CPP = 1000 x 105/60 = 1750

4. Loss on Holding Net Monetary Assets
a) Net Monetary Asset Historical Cost

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Opening</th>
<th>Closing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debtors</td>
<td>10,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Cash</td>
<td>8,000</td>
<td>5,000</td>
</tr>
<tr>
<td></td>
<td>18,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Creditors</td>
<td>12,000</td>
<td>27,000</td>
</tr>
<tr>
<td></td>
<td>6,000</td>
<td>3,000</td>
</tr>
</tbody>
</table>

Composition of closing Net Monetary Assets 6000 - 3000 = 3000

b. Loss in Holding Opening Net Monetary Assets = 6000 x 105/90 6000 = 7000 6000 = 1000

c. Gain in reduction of Net Monetary Assets = 3000 x 105/97.5 3000 = 3231 3000 = 321

d. Net Monetary Loss = 1000 321 = 769

Profit & Loss A/c CPP
Sales 43077
(-) Cost of goods sold 37423
Depreciation 1750
39173
3904
(-) Monetary Loss 769
3135

PART III
Working note:
1. Non Monetary Assets:
   a. Fixed Assets = 19000 x 105/60 = 33,250
   b. Stock CPP = 19385

2. Monetary Asset No Conversion
3. Share holders fund Balancing figure

Balance Sheet as on 31.12.1976

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
<th>Assets</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Capital (Balance figure)</td>
<td>55,935</td>
<td>Fixed Assets</td>
<td>33,250</td>
</tr>
<tr>
<td>Creditors</td>
<td>27,000</td>
<td>Stock</td>
<td>19,385</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Debtors</td>
<td>25,000</td>
</tr>
</tbody>
</table>
CURRENT COST ACCOUNTING METHOD (CCA):
The discussion on CCA method of inflation accounting which is followed is based on the statement of SAP issued by the ICA England wales.

CCA P & L A/c Related Issues:

In determining current cost profits for an accounting period, essentially 2 stages are involved:

i. Determination of Current cost operating profit: This is the surplus arising from the carrying on the ordinary activities of the business in the period after accounting for the impact of price changes on the funds for continuing the existing business as also to maintain its operating capability of business is the amount of goods and services a business able to supply with its existing resources in the relevant period. These resources are represented in accounting terms by the net operating assets (i.e. Fixed assets including trade investments, debtors, stocks, B/R, prepayments less creditors, accruals and B/P) at current cost.

The computation of surplus is to be done without considering the mode of financing the business. It is to be noted that the surplus figure is to be before interest on net borrowing and taxes.

ii. Determination of current cost profit attributable to shareholders: The figure of profit is taken after taking into account the matter in which the business has been financed. To the extent the business has been financed through borrowings the full allowance of the impact of price changes on operating capability made in arriving at net profit may not be required since the rights of lenders are fixed in monetary amount. Consequently the current cost profit attributable to the shareholders reflects the surplus for the period after considering the impact of price changes on the funds required to maintain the shareholders proportion of the operating capability. It is shown after considering interest, tax, gearing adjustment and extra-ordinary items. In the case of Balance sheet, the CCA method suggests that the assets where practicable be included at their value to the business based on current price levels. This provides a realistic statement of the assets employed in the business and enable a correlation of current cost profit with net assets employed.

Methodology of determining current cost operating cost:

In order to obtain c.c. operating profit from profit before interest on Historical Cost, 3 adjustments are involved. They are:

a. Depreciation adjustment: This allows for the impact of price changes when determining the charge against revenue for the part of fixed assets consumed during the period. It is equivalent to the difference between the value to the business of part and fixed assets consumed during the period and depreciation on Historical Cost basis.
b. Cost of Sales Adjustment (COSA): This accounts for the impact of price changes when determining the charge against revenue from stock consumed in the period. It is the difference between the values to the business of stock consumed on Historical Cost basis. The resulting total changes represent the value to the business of stock consumed in earning the revenue for the period.

c. Monetary Working Capital Adjustment: This adjustment represents the amount of additional or reduced finance needed for monetary working capital as a result of the changes in input prices of goods and services used and financed by the business. Monetary working capital represents working capital component after excluding stock.

   In other words it is the aggregate of
   i. Trade debtors, prepaid expenses, bills receivables
   ii. Stocks not subject to COSA.

Less:

   iii. Trade Creditors, accruals and bills payables

In so far as they relate to day to day operating activities of the business as distinct from transactions of a special nature. Bank balance or old may fluctuate with the net of stock or the items (i), (ii) and (iii) given above. That part of bank balance and old arising from such fluctuations should be included in the monetary working capital along with any cash floats required to support day to day operations of the business of maintenance of such floats has a material effect on the current cost of operating profit. In the case of a business which holds stocks, the monetary working capital complements the COSA and together they allow for the impact of price changes on the total amount of working capital to be used in day to day operation.

Methodology of calculating current cost profit attributable to shareholders:

   The net operating assets Fixed Assets + Stock + Monetary Working Capital are usually financed partly by borrowing and partly by shareholders funds. The financing of net operating assets by borrowing needs to be reflected in c.c. profit by means of a gearing adjustment.

   No gearing adjustment is required where a company is wholly financed by shareholders funds. The logic behind the gearing adjustments is that while repayment rights are proportion of net operating assets are realized either by sale or use in the business repayment and borrowing could be made so long as the proceeds are not less than the Historical Cost of these assets. The gearing adjustment therefore discounts the operating adjustment in the gearing proportion in deriving c.c. profit attributable to shareholders. This reduction in the operating adjustment is normally achieved by adding back all 3 types of operating adjustment Depreciation adjustment, COSA & Monetary Working Capital Adjustment in the ratio of borrowing to net operating assets. Average figures for the year are used for this purpose.

CCA B/S Related Issues:

   Fixed Assets under CCA are not shown at their original costs. They are revalued and stated at the lower of the following 2 figures:
i. **Net Current Replacement Cost**: In other words, the price which would have to be paid currently to purchase a similar asset of same age as the existing asset.

ii. Value of the asset based on the present value of the future earnings of such assets. After suitably discounting future earnings with present value tables. More specifically the SSAP 16 suggests the following basis.
   a. Land, Plant and Machinery and Stocks subject to COSA To be valued at the value to the business.
   b. Investment in associated companies Directors best estimate.
   c. Other Investments Stocks exchanges quotations or directors best estimate.
   d. Intangible asset As best estimate of value to the business.
   e. Current Assets other than those subject to COSA on Historical Cost basis.
   f. All liabilities on Historical Cost basis.
   g. Reserves in the current cost. Balance Sheet should include revaluation surplus/deficit and adjustment made to reflect the impact and price changes in obtaining the c.c. profit attributable to shareholders.

**Problem No. 2**

**Balance Sheet of Rama Ltd. As on**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Share Capital</td>
<td>150</td>
<td>150</td>
<td>Land &amp; Building</td>
<td>152</td>
<td>148</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Cost Rs. 160</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reserves</td>
<td>60</td>
<td>70</td>
<td>Equipment Cost</td>
<td>50</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Rs. 100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proposed Dividend</td>
<td>15</td>
<td>15</td>
<td>Stock</td>
<td>30</td>
<td>40</td>
</tr>
<tr>
<td>10% Debentures</td>
<td>-</td>
<td>2</td>
<td>Debtors</td>
<td>13</td>
<td>28</td>
</tr>
<tr>
<td>Creditors</td>
<td>10</td>
<td>15</td>
<td>Bank</td>
<td>(10)</td>
<td>14</td>
</tr>
<tr>
<td>Total</td>
<td>235</td>
<td>270</td>
<td>Total</td>
<td>235</td>
<td>270</td>
</tr>
</tbody>
</table>

**Profit and Loss Statement of Rama Ltd. For year ending 31.12.84:**

Rs.

Sales 100

Opening Stock 30

Purchases 61

91

Less: Closing Stock 40

Cost of goods sold 51

Gross Profit 49

Other Expenses including

10% debentures Interest 10
Dep Building 4
Equipment 10
24
Net Profit 25
Proposed Dividend 15
Balance c/f 10

Relevant price indices are:

i. Average date of building acquisition 1982 - 105
ii. 1979 Average date of Equipment acquisition and issue of equity shares - 80
iii. 1983 Last Quarter average - 114
iv. 1984 1:1 Debenture Issue - 116
v. 1984 Average - 118
vi. 1984 31.12.84 - 125

Closing stock of 1984 was acquired in the last quarter of 1984 and opening stock during 1983. Rama Ltd. Wishes to adjust its historical cost accounts respective current cost in line with CCA method.

Assuming that the value to the business of the assets is given by price indices above, prepare the accounts on CCA basis showing C.C. Adjustment for year ended 31.12.84 under following heads:

a. COSA b. Depreciation Adjustment c. MWCA d. Gearing Adjustment

Working Notes:
Part I Current Cost profit attributable to shareholders
i. COSA

<table>
<thead>
<tr>
<th>Particulars</th>
<th>HC</th>
<th>Conversion</th>
<th>CC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Stock</td>
<td>30</td>
<td>30 x 118/114</td>
<td>31.05</td>
</tr>
<tr>
<td>Closing Stock</td>
<td>40</td>
<td>40 x 118/122</td>
<td>38.69</td>
</tr>
<tr>
<td>Increase</td>
<td>10</td>
<td>Increase</td>
<td>7.64</td>
</tr>
<tr>
<td>COSA</td>
<td></td>
<td></td>
<td>10</td>
</tr>
</tbody>
</table>

COSA = 10 x 118 / 114 = 2.36

ii. a) MWCA

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Opening</th>
<th>Closing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debtors</td>
<td>13</td>
<td>28</td>
</tr>
<tr>
<td>Less: Creditors</td>
<td>10</td>
<td>15</td>
</tr>
</tbody>
</table>
### iii. Depreciation Adjustment

<table>
<thead>
<tr>
<th>Particulars</th>
<th>HC</th>
<th>Conversion</th>
<th>CC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Stock</td>
<td>4</td>
<td>4 x 118/105</td>
<td>4.05</td>
</tr>
<tr>
<td>Closing Stock</td>
<td>10</td>
<td>10 x 118/80</td>
<td>14.75</td>
</tr>
<tr>
<td>Increase</td>
<td>14</td>
<td>Increase</td>
<td>19.25</td>
</tr>
</tbody>
</table>

Depreciation Adjustment = 19.25 x 14 = 272

### iv. Total Current Cost op Adjustment = COSA + MWCA + Depreciation Adjustment

= 2.36 + 0.78 + 272 = 275.14

### v. Gearing Adjustment:

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Opening</th>
<th>Closing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholders funds (Share capital + Reserves + Proposed Dividend Miscellaneous Expenses)</td>
<td>225</td>
<td>235</td>
</tr>
<tr>
<td>Borrowed Funds (Debentures + BOD Cash balance)</td>
<td>10</td>
<td>6</td>
</tr>
<tr>
<td>Total Funds</td>
<td>235</td>
<td>241</td>
</tr>
<tr>
<td>Gearing Ratio</td>
<td>0.04</td>
<td>0.02</td>
</tr>
<tr>
<td>Average Gearing Ratio</td>
<td>0.03</td>
<td></td>
</tr>
<tr>
<td>Gearing Adjustment (CC op. Adjustment x Average Gearing ratio)</td>
<td>8.39 x 0.03 = 0.25</td>
<td></td>
</tr>
</tbody>
</table>

### vi. Creation of Current Cost Revenue

Total CC op. Adjustment = 8.39

Less: Gearing Adjustment = 0.25

Current Cost to be created = 8.14

P & L A/c Dr 8.14

To Current Cost Reserve A/c 8.14
vii. Current Cost Profit transfer to B/S

Net Profit 25
Less: Current Cost Reserve (8.14)
Proposed Dividend (15.00)
c/f to B/S 1.86

PART II Balance Sheet

i. Fixed Assets

<table>
<thead>
<tr>
<th>Particulars</th>
<th>HC</th>
<th>Conversion</th>
<th>CC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Building</td>
<td>148</td>
<td>148 x 125/105</td>
<td>176.19</td>
</tr>
<tr>
<td>Equipment</td>
<td>40</td>
<td>40 x 125/80</td>
<td>62.50</td>
</tr>
<tr>
<td>Increase</td>
<td>188</td>
<td>Increase</td>
<td>238.69</td>
</tr>
</tbody>
</table>

Fixed Asset Replacement Reserve to be created = 238.69 - 188 = 50.69

ii. Stock (Closing)

a. Historical Cost = 40
b. Value to business = 40 x 125/122 = 40.98
c. Stock Replacement Reserve = 40.98 - 40 = 0.98

iii. Total Current Cost Reserve

Current Cost Reserve (out of profits) 8.14
Add: Fixed Asset Replacement Reserve 50.69
Stock Reserve 0.98
Total Current Cost Reserve 59.81

BALANCE SHEET:
<table>
<thead>
<tr>
<th>Liabilities</th>
<th>Amount</th>
<th>Assets</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share Capital</td>
<td>150</td>
<td>Building</td>
<td>176.19</td>
</tr>
<tr>
<td>Reserve &amp; Surplus</td>
<td>59.81</td>
<td>Equipment</td>
<td>62.50</td>
</tr>
<tr>
<td>a) Current Cost Reserve</td>
<td>61.86</td>
<td>Stock</td>
<td>40.98</td>
</tr>
<tr>
<td>b) Reserve(60+1.86)</td>
<td>20.00</td>
<td>Sundry Debtors</td>
<td>28.00</td>
</tr>
<tr>
<td>Debentures</td>
<td>15.00</td>
<td>Cash</td>
<td>14.00</td>
</tr>
<tr>
<td>Creditors</td>
<td>15.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proposed Dividend</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>321.67</td>
<td></td>
<td>321.67</td>
</tr>
</tbody>
</table>

Recommended Read
- New Lease Accounting Standard
- MBA in Forensic Accounting

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CA MOHIT SAXENA

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