INFLUENCE OF INFLATION ON CAPITAL

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Abstract: *Establishing a business, maintaining market position and support its growth requires resources to conduct, under optimum conditions of development activities. Creation and functioning of a society is not possible without capital can be considered a set of resources likely to provide future revenue streams. Capital firm, as sources of funding to the fixed, the equivalent value of the resources invested in property assets of owners (equity) or third parties.*

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Inflationary phenomena exert a "bad" on the financial statements of an enterprise, in that they will not play fair view, clear and complete assets, financial position, performance, changes in equity and cash flows.

Following the most accurate representation of the enterprise faced with inflationary environment, several authors have tried to develop accountants accounting methodology to be implemented to mitigate and even eliminate accounting distorted representation of reality, in terms of inflation. Thus emerged a concern for creating inflation accounting (or more correctly, an inflation adjusted accounting).

Current inflation accounting methodologies[1] aimed at ensuring the maintenance of financial capital (net assets or equity) and maintenance of physical capital (the productive capacity of the company, expressed usually by physical units produced). Most authors recognize two categories of methods of accounting for inflation:

- Conversion methods or methods based on historical cost index (also called accounting expressed in constant purchasing power);
- Methods based on the evaluation (or current value accounting).

Some authors use and combined methods that account for the characteristics of the two alternatives.

Conversion methods are based on methods aimed at quantifying the incidence of currency depreciation on the synthesis accounting documents and financing company. These methods consist of partial or total re-evaluation of positions in the financial statements to a change in the general price level.

The objective of this method is to obtain a result which takes into account the corrections necessary to maintain the purchasing power of the equity of a company operating in an inflationary environment (in this sense favors the maintenance of financial capital to maintain the productive potential of the company).

An essential feature of conversion is based on indexing methods based on index that measures the purchasing power of national currency (the general index of price increases). Price index used to measure depreciation of purchasing power must be representative and accepted by the users of accounting information processing based on his subject (it is known that a price index is an imperfect representation of reality which, moreover, can suffer interference "political "from those interested). In the general price index may be chosen as a reference price at the end (measuring in monetary units by end of period) or a unit during the year (measuring the average purchasing power during the year). Most often opt for a mixed solution, that balance is expressed in monetary units constant at a certain time (eg, conversion of balance sheet items in monetary units with purchasing power at the end of the year, this solution involves amortismentelor adjustment).

Conversion methods are based on accounts indexed to the evolution of purchasing power of domestic currency, which is based on generally accepted accounting principles (such as double, prudence, etc..) And established based on historical cost accounting.

Inflation causes, simultaneously, at a company a loss of purchasing power of cash and non-indexed debt and non-indexed debt gain, that the company supports an inflationary[2] gain or loss. Accounting aims to measure the consequences indexed depreciation, incurred by the enterprise in the form and attach inflationary gains or losses in total, profit or loss. In determining gain or loss of inflation has an important role distinction between monetary and non-cash items of the balance sheet. Although accounting doctrine is not the same views in determining the monetary monetary items may be taken into account the following general considerations:

[1] Ristea M., Dumitru CG - Advanced Accounting, University Publishing House, Bucharest, 2005
[2] Ristea M., Dumitru CG - Advanced Accounting, University Publishing House, Bucharest, 2005

- Monetary assets are funds that can be affected by the acquisition of goods and services (claims and availability);
- Monetary assets consist of tangible assets (land, fixed assets, stocks) and some intangible assets (patents, trademarks, etc.).
- Monetary liabilities are the debts that can be settled by the payment of monetary assets and not the furnishing of goods or service;
- Monetary liabilities are the debts that can be settled by delivery of goods or services. Comparison of monetary assets with monetary liabilities determines the indicator "net monetary position" of the company, ie:

Monetary assets = net monetary situation - monetary liabilities

The incidence of inflation on the purchasing power of equity depends on the relative importance of monetary assets and liabilities. Thus, if the monetary situation is positive, ie monetary assets are high debt, rising prices generate a loss of purchasing power, reducing the value of cash and receivables because inflation is higher due to debt reduction.

When a negative net monetary position (monetary liabilities of the asset is surplus money bud), results in a gain to the firm, because the loss of purchasing power of monetary assets is more than offset by lower debt. More concise, in a period of negative net monetary inflation situation (monetary liability is superior to monetary assets) favors company, as a gain resulting from repayment of loans contracted in the past, the currency depreciated.

Require assessment methods based on the establishment, or part of the historical cost as the basis for assessing the current[3] cost balance sheet items, ie, most often at the cost of replacing these items. Objective application of current cost-based methods is to obtain a result which takes into account the corrections needed to ensure maintenance of operating capacity of the company.

Depending on the specific prices of certain categories of assets may be considered as forms of actual cost:
- Replacement cost (or reproduction);
- Net of realization;
- Present value (economic value or usage).

Since the two methods are based on inflation adjusted accounting criteria different wear and combined methods of correcting the value of accounts. The objective of applying the combined approach is to maintain capital at constant purchasing power and cost evaluation of replacement goods (current values).

Traditional accounting model, based on historical cost principle (also called conventional accounting), fails to represent an economic reality characterized by varying purchasing power of money. Under these conditions, accounting provides a distorted picture of reality, what i seriously alter the quality of cognitive model of reality affecting management decisions and firm behavior in general. Financial terms, the state changes the inflationary economy of treasury management firm. To meet ever-increasing cash needs (price increase leads to an increase in money supply), companies are tempted to keep large sums in cash, resulting in serious losses because cash holding monetary assets loses purchasing power . To this is added pressure on the treasury in the payment of dividend taxes overestimated and some fictitious. In such a situation, companies pay their dividends by reducing taxes and social substance of property, namely the capital account, resulting in de-capitalization of the company.

Because a reduction of self-financing capacity, firms gets funding sources and increasing recourse to debt capital. In terms of inflation, both solutions have a negative impact on the financial balance of the company. Increased borrowing in periods of inflation leads to excessive interest charges, especially when real interest rates positive practice banks (interest rate paid by banks is higher than the inflation rate). Recourse to financing capital growth and therefore the issue of new shares lead to increased capital market firm dependency, located in such a period in a situation "depressed", which may lead to a reduction in earnings per share, lower equity prices and thus damage the company image in front of investors. The persistence of inflationary phenomenon changes the firms through actions such as expectations of inflation rates, investment, trade credit to avoid the sale.

If the company acts in the inflationary environment, the quality of accounting information may be damaged, the annual financial statements are no longer able to play fairly the financial position, performance, changes in equity and cash flows.

To limit the effects of inflation produced distortions in historical cost accounting, in the absence of inflation accounting, companies can re-use as a partial solution to the problem of the influence of inflation on financial statements.

Article 33 of the Fourth European Directive, notwithstanding the previous article (which provides for the valuation of the annual accounts based on the principle of acquisition cost or full cost), leaves Member States the option, until subsequent coordination, to train or require all companies or certain categories of fixed assets revaluation companies, as well as financial[4] assets. Revaluation reserve may receive the following treatments:
- Can be converted into capital for all or parts of it at any time;

[3] Ristea M., L. Olimid, Calu YES - comparable accounting systems, CECCAR House, Bucharest, 2006
[4] Staicu C. - Financial Accounting harmonized with European Directives, CECCAR House, Bucharest, 2002

- Is not distributed, except where not only corresponds to an actual capital gains;
- Need to be liquidated to the extent that the amounts concerned are no longer necessary to apply the valuation method used and its objectives.

Unamortised revaluation of property, revaluation involves recording gap in the equity structure, the spread can not be dismissed, can not be used to offset losses and is not retained in the definition of equity participation by employees serving in profit calculation.

Regarding the balance sheet, non-cash items will appear undervalued in the financial statements and the related monetary items can find a holding gain or loss. In terms of profit and loss, the phenomenon of synchronization (costs are expressed in monetary units are expressed prior to the corresponding income). So far there was no consensus on the use of valuation bases.

Using historical cost is unfavorable influence on the non-cash items, as the monetary values are highlighted in the current accounting balance sheet date. Therefore, in terms of inflation, historical cost information respecting become interpretable. IAS 1 states that "financial statements based on historical cost model is useful only if they are expressed in terms of the measuring unit current at balance sheet date." Companies will have to take into account the objective of maintaining capital (physical and financial), as hyperinflation under capital is subject to erosion.

According to the IASB conceptual accounting framework, § 104 lit. (a) maintain financial capital refers to a situation where "profit is obtained only if the financial value (or monetary) of net assets at the end is greater than the financial (or money) of net assets at the beginning of the period, after excluding any distributions to owners, and any contributions from the owners during the period analyzed. "

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According to the IASB conceptual accounting framework, § 104 lit. (b) maintenance of physical capital refers to the situation in which profit is obtained only when the physical productive capacity (or operating capability) of the company (or resources, funds necessary to achieve that capacity) at the end of the period exceeds the physical productive capacity the early period after any distribution to owners and excluded any contribution from the owners during the period. While physical capital maintenance concept requires the adoption of current cost as a basis for evaluation, the financial capital maintenance concept does not require use of a certain valuation bases, selecting it depending on the type of financial capital that the company intends to maintain it .

In order to avoid distortions created by inflation historical cost accounting is necessary to supplement information provided by the elements of accounting generated inflation. Thus, the historical cost system will be replaced wholly or partly based on the current value system. In accordance with International Accounting Standards, the system can use several bases of evaluation: current cost, realizable value, present value, fair value.

For the purposes of accounting for inflation, have outlined three methods of correction:

- Correction of the financial statements the effects of inflation based on methods based on the purchasing power of money;
- Correction of the financial statements the effects of inflation based on the use of methods based on current costs;
- Correction of the financial statements the effects of inflation based on the combined approach, using techniques for the two categories listed above.

According to IAS - 21, "The Effects of Changes in Foreign Exchange Rates", components of equity, except retained earnings and any revaluation surplus, are restated by applying a general price index from the dates on which components were or appeared intake other ways. Any revaluation surplus that arose in previous periods is eliminated. Restated retained earnings are derived from all other values of the restated balance sheet.

At the end of the first period and in subsequent periods, all components of equity are restated by applying a general price index from the beginning of the period or the date of contribution, if it was later. Changes in equity during the period are presented in accordance with IAS - 1 "Presentation of Financial Statements".

Neretratate equity elements is determined by the residual based on relationships:

a) diversion of net assets or equity from the Restatement
Net assets or Equity restated = Asset restated - Debt restated
b) determining the restated results:
The result restated to N = Restated net assets at N - Restated net assets at N – 1
c) restatement of capital and capital-related bonuses depending on the general price index:
Capital and The first related to capital = Capital and The first related to capital x The conversion factor
d) the calculation and other structures restated equity residual method:
Reserves and other restated equity = equity restated - Share capital and capital related raw restated - The result restated

Dissemination of the elements and other equity reserves is the ratio of weight in the balance sheet historical cost.

At the end of the first period and subsequent periods all components of equity are restated by applying a general price index to start the period beginning on or after the date of contribution, if it is later. In the literature is presented and the method for reprocessing waste all equity.

Opposable account relationships for this purpose are:

a) determining the restated net assets or capital:
   Net assets or restated equity = asset restated - debt restated
b) determining the restated results:
   The result restated to N = Treated net assets N - Treated net assets N - 1
c) calculating the residual equity:
   Residual equity N = Treated net assets N - Treated net assets N - 1
   Separation of each balance sheet equity position, including capital share is based on the historical cost restated balance sheet.

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