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Evaluation of Applications Used in Inflation Accounting Regulations

Enflasyon Muhasebesi Düzenlemelerinde Kullanılan Uygulamaların Değerlendirilmesi

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Abstract

Inflation accounting came back to the agenda years after the November 2021 inflation data, which signaled a high inflation process in our country, were announced. When the December 2021 inflation data were disclosed, the talk of inflation accounting practices gained momentum. This study aims to explain what inflation accounting is, how it is applied, and how it is used in different countries. After the literature study on inflation accounting practices, the decisions taken on implementing inflation accounting, which came back to our country's agenda in November 2021, were announced.

Keywords: Inflation, inflation accounting, reorganization processes

Öz

Enflasyon muhasebesi, ülkemizde yüksek enflasyonlu bir sürece sinyal veren Kasım 2021 enflasyon verilerinin açıklanması sonrasında yıllar sonra tekrar gündeme geldi. Aralık 2021 enflasyon verileri açıklanınca ise enflasyon muhasebesi uygulamalarının konuşulmaya başlaması hız kazandı. Bu çalışmada enflasyona dair bilgiler verilip, enflasyon muhasebesinin ne olduğu ve uygulanma şekillerinin neler olduğu ile farklı ülkelerde enflasyon muhasebesinin nasıl uygulandığına dair bilgi vermek amaçlanmıştır. Enflasyon muhasebesi uygulamalarına dair yapılan literatür çalışmasının ardından ülkemizde Kasım 2021 itibariyle gündeme tekrar gelen enflasyon muhasebesinin uygulanmasına dair alınan kararlar açıklanmıştır.

Anahtar Kelimeler: Enflasyon, enflasyon muhasebesi, yeniden düzenleme işlemleri

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Introduction

What Is Inflation?

Inflation is the decrease in the purchasing power of money due to the increase in the price levels of the goods produced and the services provided. The main factor affecting inflation is the increase in the prices of goods or services and the decrease in purchasing power due to the rise in the general price levels of goods and services. Another factor to consider is that inflation is a continuous increase in said prices rather than a one-time increase.

If we answer the question of what inflation is with an example, paying 50 Turkish Lira (TL) for the products you bought from the market in January 2021 and 100 TL for the same products in January 2022 means that annual inflation is relatively high. In short, it indicates the decrease in purchasing power due to the increase in the prices of goods in the last year.

What Are the Types of Inflation?

Inflation does not occur for a single reason. The causes of inflation are not only of monetary origin but may also arise as the cause of imbalances in the goods market. In addition, inflation can arise from domestic events and different reasons that occur abroad. As the causes of inflation changed, different types of inflation emerged.

As can be seen, inflation types are divided into two main headings: In the first main title, inflation types are based on the rate of increase in prices, while in the second main title, a distinction is made according to the causes of inflation. Under the main heading of inflation types according to the rate of increase in prices; moderate inflation, hyperinflation, and hyperinflation. If it is under the main heading of inflation according to its reasons; demand inflation, cost inflation and structural inflation are explained.

1. Types of inflation by rate of increase in prices

- Moderate inflation: The increases in the prices of goods and services are very low, and inflation expectations are not formed.
- High inflation: By causing damage to the economy, it upsets the balances in the functioning of the markets, increases uncertainty about the future, and weakens the value of money.
- Hyperinflation: It exceeds 1000% annually or 50% monthly, causing money to lose all its functions.

2. Types of inflation by causes

- Demand inflation: Demand inflation occurs if the aggregate demand level exceeds the supply and causes a steady price increase. In other words, demand inflation occurs due to increased consumption expenditures and, indirectly, the money supply level.
- Cost inflation: Inflation affects not only demand but also supply. Therefore, prices tend to increase steadily due to the rise in the cost of goods and services used for input during the production phase, leading to inflation. In addition, cost inflation occurs due to wage–income conflict and rising domestic or imported input goods such as oil prices.
- Structural inflation: Structural inflation occurs when the supply cannot meet the demand due to problems. Structural inflation has a more detailed reason than monetary policies, and the primary factor is that production rates cannot keep up with the order.

What Are the Effects of Inflation?
A high inflation rate has many negative consequences, both temporary and permanent.

- Income distribution inequality increases, and families with low and fixed incomes are adversely affected. The purchasing power of the consumer decreases.
- Borrowing costs increase; in this case, people who borrow foreign currency or gold have difficulty paying, because TL loses value against foreign currency or gold.
- The country has difficulties in foreign payments because foreign payments are made in dollars and euros.
- Interest rates increase, and this causes a decrease in investments, because investors tend to earn interest income rather than take risks.
- There is an imbalance in the rate of increase in prices, which makes the market uncertain.
- Due to the value of money, there is a decrease in saving tendencies; therefore, consumption increases while the savings volume decreases.

How Is Inflation Calculated?
While calculating inflation, support is obtained from official statistical institutions. In Turkey, the institution that receives support while calculating inflation is the Turkish Statistical Institute. Official statistical institutions create indices by conducting detailed research in many areas, such as markets, gas stations, and service providers, to examine monthly price changes. Inflation is calculated using these indices. Two primary indices are used in the calculation of inflation; these are:

1. Consumer price index (CPI)
2. Domestic producer price index (D-PPI)

CPI and D-PPI are the price indices that help measure the changes in the prices of the producer part of the products produced in the country's economy and sold.

Inflation Accounting

What Is Inflation Accounting?
Grant Thornton Turkey's partner Ahmet Cangöz explained the term inflation accounting, which came to the agenda again with the recently announced inflation rate in a program he attended, with the following words:

> "With the announcement of the inflation rate on December 4, this term entered our agenda. The high domestic PPI rate aroused a dormant clause in the law. This article is according to the tax procedure law; If there is a total increase of 100% in the Domestic PPI index in the last three years, if there is an increase of more than 10% in the current year, should apply inflation accounting.
>
> To give an example, tradesmen complain in the market. The price goes up until I buy a replacement for the item I sold. As a result, the values of the previously purchased goods appear low on their balance sheets. Affects their credibility and does not articulate the reporting function correctly when managing their business" (https://www.bloomberght.com/enflasyon-muhasebesi-nedir-2293871, accessed date: January 5, 2023).

Inflation accounting of International Accounting Standards (IAS) is applied internationally under the generally accepted accounting standards (generally accepted accounting principles) published by the Financial Accounting Standards Board (FASB). Inflation accounting is defined as follows according to standard No. 29 titled "Financial Reporting in High Inflation Economies," which refers to:

> "Inflation accounting is the indexing operations performed to eliminate the deterioration in the financial statements and to bring the historical or book values in the financial statements to the market values in case the three-year cumulative inflation approaches 100% and the inflation increases by 10% or more compared to the beginning of the accounting period" (International Accounting Standard IAS-29, Reformatted 1994, Scope:5).

Financial statements, thanks to the financial and non-financial information they contain, inform many stakeholders about the financial status and financial performance of the enterprises, the changes in the economic conditions of the enterprises, and the changes in the cash flow in the reporting of the accounting

movements and the interpretation of the report results. While current accounting practices are mainly applied over the monetary value on the transaction date, financial statements are prepared using accounts with a historical transaction value. However, the price movements are unstable in some periods. Therefore, the financial statements prepared in these periods can only fulfill their function if they are designed with considering the price movements. If price movements are not considered, operating results can be seen as more or less than the truth, and these results misinform buyers. For example, imagine an economy where the price movements change significantly. According to historical data, if a good bought for 30 TL is sold for 50 TL after a while, it will report a profit of 20 TL. However, if the value has increased to 40 TL, the actual gain will be 10 TL, not 20 TL. In short, as prices rise, the purchasing power of money decreases. Inflation accounting examines the changes in price movements and reflects the results in the financial statements. This process corrects changes in price movements (Logo – Tiger Plus, 2016).

There are methods that companies have created to protect themselves from the harmful effects of inflation and that they partially benefit from. In reducing and improving the detrimental effects of inflation, it is necessary to use more comprehensive models due to the need for more partial correction models and excessively high inflation rates. Utilizing these wide-scale models will ensure that the financial statements prepared and presented by the enterprises reflect the truth and that they are comparable, another essential feature of the financial statements. General correction methods differ from partial adjustment models because, rather than adjusting accounting records or financial transactions, it is aimed at creating financial statements that are organized following the purposes of the accounting transaction and comply with accounting principles. General adjustment methods in the accounting world are also called inflation accounting (Erdemir, 2005).

The most straightforward answer to the question of what inflation accounting is as follows: it is a function of describing the purchasing power of money in a given period in terms of the purchasing power of money in another period (Savlı, 2004).

What Is the Purpose of Inflation Accounting and the Reason for the Evening?

While the method called historical cost accounting, which is used when the prices of the products produced and the services offered are stable, is a sound system in terms of usage, in periods when prices are unstable, this system is unlikely to be a helpful model. This is because the financial information prepared and presented according to the historical cost accounting system in periods when prices are unstable reduces the benefit of financial information users. The main reason for the decrease in the help provided is that the valuation model and valuation criteria used in the historical cost accounting system must be more sufficient when prices are unstable. In economies where price changes occur suddenly and continuously, the historical cost accounting system needs to be revised in terms of use. Because of this inadequacy, the system is criticized if used in such economies. In addition to the criticisms, it was also discussed in terms of actuality and mentioned that it is not up-to-date. Thus, the search for new systems that can be used for environments where the prices of products and services frequently change has begun (Yüksel, 1997).

It is possible to determine the purpose of inflation accounting based on the definition of inflation accounting. Inflation accounting is an accounting system that shows the effect of price changes on the business values reflected in historical costs in the financial statements prepared and presented by the businesses. An accounting system benefits the business value by remembering the truth by taking measures in line with these effects. The simplest definition of inflation accounting is as we mentioned above. It is possible to define the purchasing power of money in one period in terms of the purchasing power of money in another. In this direction, inflation accounting aims to reorganize the financial statements prepared and presented by the enterprises according to the purchasing power of money at the end of the period. Corrections during this editing process are made on the tables not the records (Lazol, 2000).

How Is Inflation Accounting Applied?

Traditional accounting practices were insufficient during high inflation, and so some inflation accounting models were developed. In all the models developed, inflation accounting systems and traditional accounting applications work as a whole, but the operations of the inflation accounting system are carried out by dividing them into periods. According to the operating models of the inflation accounting system, three different inflation accounting models have been developed. These methods are as follows: general price level accounting method, current cost accounting method, and mixed method (Hacırüstemoğlu, 1999).

1. General price level accounting method: It arranges financial statements through a generally accepted index to minimize the effects of the general changes in the prices of the products produced and the services offered on the financial statements. In the general price-level accounting method, the measurements of the historical cost accounting system are used. The purchasing power of money, which shows the general level of the prices of the products produced and the services offered, is used rather than monetary expressions based on these measurements. In short, according to the general price-level accounting method, the financial statements prepared and presented by the enterprises at the end of the period are rearranged according to the purchasing power of money.
2. Current cost accounting method: The replacement cost accounting method is also used. Based on the current cost accounting method, special price changes that do not comply with the generally accepted trends should be considered separately since changes in unique price movements proceed differently from changes in general price movements, and even occasionally, changes in unusual price movements take the opposite direction of changes in general price movements. Therefore, it is considered

a category. While developing the current cost accounting method aims to protect the physical capital and show the historical costs in the financial statements in terms of their current values.

3. Mixed method: This method combines the general price-level accounting system and the current cost accounting system. Since it would be more beneficial to adjust the financial statements prepared according to the particular levels of prices in the mixed method according to the general levels of prices at the end of the period, the natural and unreal amounts of the holding gains and losses of monetary values and the holding gains of non-monetary values can be revealed. Therefore, the mixed method is the most useful inflation accounting method as it contains the positive aspects of the general price-level accounting system and the current cost accounting system (Uman, 2002).

Table 1 compares the historical cost accounting method, general price-level accounting method, current cost accounting method, and mixed method used in inflation accounting transactions in terms of their strengths and weaknesses (Gökçen,2004).

How Does Inflation Accounting Systematics Follow?

Abdulkadir Kahraman, Partner of EY Turkey Tax Division, discussed the functioning of the inflation accounting system in his letter dated January 7, 2022. Table 2 mentions the working process of the inflation accounting system (https://www.ey.com/tr_tr/tax/enflasyon-duzeltmesi-yap-ama-matrah-degismesin-gecmise-donus, accessed date: January 6, 2023).

Inter-Country Inflation Accounting Practices

What Are the Development Stages of Inflation Accounting in Turkey?

When the studies on the application of inflation accounting are examined, it is seen that the studies on Inflation accounting in our country date back to the 1950s. Notably, this application system, known as inflation accounting, was used as a revaluation system in previous studies. When the research on inflation accounting is examined, it can be seen that there was no regulation on inflation accounting in the years when inflation rates increased rapidly in our country. However, between 1954 and 1959, after the State Economic Enterprises and private sector enterprises were adversely affected by the high inflation rates, reform commissions were established, and reports on inflation accounting were published. The Tax Reform Commission was established in 1961, and the concept of revaluation emerged within the commission's recommendation (Uman & Hacırüstemoğlu, 2004).

The concept of revaluation has thus entered our literature, but revaluation studies could not be implemented in our country until 1983, since the Ministry of Finance published revaluation rates. Although it was foreseen to use the historical cost accounting system at the end of the rapid increase in inflation rates experienced in our country with the revaluation practices since the desired results could not be obtained in the economies in the periods when the inflation remained stable, the revaluation practices were made continuous. The revaluation rates were regularly updated by the ministry every year. Revaluation practices have gained a permanent place with publication (Yüksel, 1997).

In addition to all these, partial protection methods have been developed, and it is aimed at eliminating the adverse effects caused by high inflation. Partial protection methods are listed below:

- LIFO (last in, first out) method in stock valuation application,
- Depreciation method based on diminishing balances,
- Revaluation method,
- The method of increasing the cost price,
- Indexing method in investment discounts,
- Restriction method in financing expenses,
- Rediscount method in bills receivable and payables,
- Backup and auto financing method,
- Renewal fund method, and
- Tax deferral method of R&D expenditures (Öztürk et al., 2004).

What Are the Regulations Published on Inflation Accounting in Our Country?

Inflation accounting practices in our country date back to the 1950s, and many regulations have been published on inflation

Table 1.
Comparison of Inflation Accounting Methods

Inflation Accounting Methods	Historical Cost Accounting Method	General Price-Level Accounting Method	Current Cost Accounting Method	Mixed Method
In terms of purchasing power	Low	High	Middle	High
In terms of operating profit and profit on retention	Low	Low	Middle	Middle
In terms of current values	Low	Low	Middle	Middle
In terms of influencing inflation	Low	Low	Middle	High
In terms of objectivity	High	Middle	Low	Low
In terms of validity	Low	Low	Middle	High

Table 2.
Systematic Operation of Inflation Adjustment

Have the conditions been met?	As of December 31, 2021, the increase in PPI is more than 100% in the last three accounting periods and more than 10% in 2021	The inflation adjustment is made!
Where and how are the values after correction taken into account?	Adjusted values are the starting values of the following period, whether or not inflation adjustment is made in the next period	Inflation adjustment conditions are determined by multiplying the non-monetary assets at the close of the period in which the adjustment coefficient does not meet the needs to determine the amounts to be taken into account in the inflation adjustment to determine the realized accounting period profit/loss. Inflation adjustments are recorded in the related securities and the inflation adjustment account versions (VUK Communiqués 328 and 338) In the disposal of the adjusted assets, the related inflation adjustment differences are considered costs (according to the provisional article 25 of the TPL, "in case of sale of non-depreciable assets below their adjusted value, the loss corresponding to the difference between the adjusted value and the pre-adjustment value is a legally unacceptable expense.
How are depreciation and amortization calculated?	Adjusted values are taken as a basis for calculating depreciation and amortization	Adjusted values are also taken into account in sales
When will the inflation adjustment be started if the correction conditions occur again?	Adjustments are made starting from the most recent inflation-adjusted period. The previous year's profit determined in this way is not taxed, and the loss of the last year cannot be deducted from the tax base However, in the determination of the base, the financial losses of the previous years are taken into account with their recorded values	The profit or loss arising up to the last adjusted period and when the conditions are met is not considered (as the requirements are fulfilled as of December 31, 2021, the balance sheet values of December 31, 2020, for the previous accounting period are corrected)

Note: PPI = producer price index.

accounting practices until today. These regulations are as follows:

1. International Accounting Standards-29: It is standard No. 29 published by the International Accounting Standards Committee, established in London in June 1973 by Sir Henry Benson, the former president of the Institute of Chartered Accountants. The standard was published under the name Financial Reporting in High Inflation Economies. The content of the standard includes the effect of inflation in periods of high inflation, how to correct the financial statements after this effect, how to follow if high inflation rates decrease, and how all these transactions will be explained in the financial statements. The IAS-29 standard has affected the financial information prepared and presented on and after January 1, 1990.
2. CMB Communiqué Serial: XI N:20: In the Communiqué on the Procedures and Principles Regarding the Adjustment of Financial Statements in High Inflation Periods, which entered into force with the Official Gazette No., some rules must be followed. Provisions in the Communiqué shall be applied to the financial statements annually for the period of December 31, 2001, and for the periods after this date as interim and annual.
3. Communiqué No. 14 Prepared by the BRSA: The Communiqué, published in the Official Gazette dated June 22, 2002, and numbered 24793, explains the preparation methods of the financial statements in periods when inflation rates are high by the Banking Regulation and Supervision Board. It is called the Accounting Standard for the Adjustment of Inflation Periods. In this paper, the calculation methods of the correction coefficients and what should be done if the inflation rises come to an end are also explained in detail.
4. General Communiqué on Accounting System Implementation: In the communiqué published in the Official Gazette dated May 5, 2004, and numbered 24453, the accounts to be added as adjustments to the uniform chart of accounts through inflation accounting and how these accounts will work are explained in detail.
5. Tax Procedure Law Circular and Communiqués: If deemed necessary by the Ministry of Finance, General Directorate of Revenues, some circulars and communiqués have been published in the inflation accounting process applied to the financial statements.
6. Law No. 5024 Published by the Ministry of Finance: According to the Tax Procedure Law, which was published in the Official Gazette dated December 30, 2003, and numbered 25332, following the Law on the Amendment of the Income Tax Law and the Corporate Tax Law, efforts have been made to eliminate the negative effects of inflation on the financial statements in our country.

How Is Inflation Accounting Implemented in Other Countries?

1. The USA: Although the Accounting Principle Boarding proposed the presentation of financial reports prepared according to the changes in the general price level in addition to the historical cost system in 1969, it was not generally accepted by the enterprises due to the lack of any coercive effect. In 1974, if the inflation rate was 11%, the recommendation made by the Accounting Principles Organization 5 years ago was renewed by the FASB. The use of accelerated depreciation and LIFO methods was also allowed in the USA. In addition to these studies, the Securities And Exchange Commission contributed to inflation accounting studies by requesting additional reports on current replacement costs from businesses whose tangible assets exceed 100 million dollars and whose tangible fixed assets exceed 10% of their total assets. It is obligatory to publish the replacement costs of their stocks and fixed assets in addition to the financial statements arranged with the general price level of the companies that comply with the criteria determined by the standard No. 33, titled Financial Reporting and Changing Prices, published by the FAS in 1979. When the inflation rate fell below 3%, this requirement was abolished with standard No. 89 (Akdoğan, 2004).
2. Germany: The first study on inflation accounting was in 1924, and the historical cost accounting system was applied during the periods when inflation rates were stable. It has been suggested by the Accounting Principles Committee that the use of special price indices will be beneficial if current prices cannot be obtained (Yüksel, 1997).
3. Canada: Studies were followed closely in countries with an inflation rate of 9% and below. The general price-level accounting determined by the commission formed by the Canadian Institute of Chartered Accountants members in 1972 was accepted. The Accounting Research Committee has announced that general price level, current cost accounting, or mixed model methods can be used in preparing financial reports. However, it has not put any pressure on its application. Studies on current cost accounting continued until 1976, and current values were accepted in 1976. While the USA and England argue that capital should be protected as a productive power, Canada argues that wealth should be saved as a purchasing power (Akdoğan, 2004).
4. Australia has a similar inflation accounting application system to the UK. In the first stage, the general price-level accounting was adopted in the country, but businesses need help to adapt to this system. According to the accounting standards that came into force in 1976, current values came to the fore. It has been accepted that since 1977, financial reports prepared and presented based on current values must be submitted in an additional way. It has become obligatory to offer them as of the following date. However, since the inflation rates were low in the subsequent years, the implementation was not continued (Akdoğan, 2004).
5. Austria: When the currency used in the country depreciated, revaluation applications were started to be used, and the fixed assets, stocks, and receivables of the enterprises were revalued, but the application was not compulsory. In 1967, current cost accounting started to be used.
6. Belgium: The practice of disclosing the effect of price changes on depreciated fixed assets and inventories has been accepted. The adjustments applied in the country are based on the replacement cost accounting model.
7. Brazil: Fixed assets were revalued in 1951, and after this implementation, in 1973, it was decided to evaluate the financial and non-financial information included in the financial statements.
8. France: In some periods until 1958, non-compulsory revaluation applications were made with coefficients, and the desired outputs could not be obtained due to the lack of necessity. In the future, in addition to the reports prepared following the historical cost accounting system, it was requested to present the reports prepared following the general price-level accounting system. In addition to all these, due to the differences between the current cost accounting system and the tax system, it has been decided that the reports prepared following the current cost accounting system can only be presented with additional information. Since there is no inflation in France, no application has been made.
9. England: Since there is an obligation to publish financial reports according to the accounting rules applied in the country, the development stages of inflation accounting have been taken to investigate whether the published financial statements reflect the truth. The current value accounting system was first applied in the country, but when inflation became controllable, the current value accounting system applications were not used. However, when inflation rates started to increase again, the general price-level accounting system presented by The Institute of Chartered Accountants in England and published by the Accounting Standards Steering Committee began to be implemented in 1973, and financial reports started to be prepared following this system. With some pressures, the current cost accounting system was implemented instead of the general price-level accounting system, but it was optional. The system, which continued in this way until 1988, was abolished due to the decrease in inflation rates.
10. Netherlands: Replacement cost practices have been adopted in the country, reports prepared following the current cost accounting system are published, and the activity results prepared following the historical cost accounting system are presented as an appendix.
11. Argentina: In the 1960s, coefficients were published to make adjustments to fixed assets, and after 1972, the general price-level accounting system was started to be used within the framework published by the Argentine Technical Institute of Accountants.
12. Denmark: The effects of price changes were only seen in fixed assets. The increase in value due to these changes was recorded in special fund accounts, limiting profit

distribution. In recent years, stocks have been valued at net realizable value.
13. Sweden: As of 1994, the principles of replacement cost accounting have been adopted, and unique indices have been used with this principle.
14. Italy: Fixed assets are revalued through unique indices.
15. Japan: The practice, which started as a desire-based system at first, became the mandatory adjustment of fixed assets after 1954, and there was no revised decision in the indices used.

Worked Resources on Inflation Accountıng

Most of the studies dealing with inflation accounting are based on old years. Table 3 contains a literature review of the sources studied on inflation accounting.

Instance

Since our example was created using a source prepared to explain the inflation accounting system applied in previous years, the balance sheet and income statement dates show the last years (Demir, 2006).

ABC trading business was established on May 1, 2002, with a cash capital of 10,000,000 TL. In June of the same year, cash fixtures were purchased for 5,000,000 TL. In addition, ABC's trading business did not operate in 2002–2003 (non-profit); it only paid 2,000,000 TL in 2002 and 1,500,000 TL in 2003 for some expenses such as rent, electricity, and water.

When ABC's trading business was established, it chose the usual depreciation method as its policy and set aside 20% annual depreciation.

Wanted:

a. To prepare the establishment of the balance sheet of ABC trading company,
b. To prepare the 2002 income statement of ABC commercial enterprise,
c. To prepare the balance sheet of ABC trading company dated December 31, 2002,
d. To prepare the 2003 income statement of ABC commercial enterprise,
e. To prepare the balance sheet of ABC trading company dated December 31, 2003,
f. To adjust the balance sheet of ABC trading company dated December 31, 2003, by the Law No. 5024 and related communiqués.

ABC Trade Company Establishment Balance Sheet dated May 1, 2002

I Current assets		10,000,000
1 Cash	10,000,000	
II Fixed Assets		
Assets Total		10,000,000
III Short-Term Foreign Resource		
IV Long-Term Foreign Resource		
V Equity		
1 Capital	10,000,000	10,000,000
Passive Total		10,000,000

Since ABC's trading business had no commercial activity in 2002, there will be a loss caused by operating expenses in the income statement. Therefore, depreciation has been calculated as 5,000,000 TL × 0.20 = 1,000,000 TL.

ABC Trade Company Income Statement for 2002 Operating Period

Gross Sales		
(Returns and Discounts)		
Net sales		
(Cost of sales)		
Gross profit (loss) on sales		
Operating expenses		(3,000,000)
(General and administrative expenses)	(2,000,000)	
(Depreciations)	(1,000,000)	
Operating profit (loss)		(3,000,000)

The balance sheet of ABC's trading business dated December 31, 2002, will be as follows, together with the transfer of the net loss in the income statement for the 2002 operating period to the balance sheet.

ABC Trading Company Balance Sheet dated December 31, 2002

I Current Assets		3,000,000
1 Cash	3,000,000	
II Fixed Assets		4,000,000
1 Fixtures	5,000,000	
2 Accumulated Depreciation	(1,000,000)	
Assets Total		7,000,000
III Short-Term Foreign Resource		
IV Long-Term Foreign Resource		
V Equity		7,000,000
1 Capital	10,000,000	
2 Period Loss	(3,000,000)	
Passive Total		7,000,000

Since ABC's trading business had no commercial activity in 2003, there will be a loss caused by operating expenses in the income statement. Depreciation has been calculated as 5,000,000 TL × 0.20 = 1,000,000 TL.

Table 3.
Studies on Inflation Accounting

Workıng Year	Author/ Authors	Purpose of the Study	Method	Conclusıon
1993	Prabhat Ranade	It is aimed to make a historical review of the evolution of inflation accounting standards in some industrially developed countries	The published standards on the inflation accounting system were examined	The applicability of different inflation accounting techniques in Indian conditions is evaluated
1994	Jane OM. Ande	It is aimed to test the effects of inflation on the accounts	For this purpose, a live company was selected, and all analyses were made	On the other hand, the analysis proved that not accounting for inflation in financial reports leads to incorrect information about the economic situation
1994	Keith Robson	It aims to investigate the problems experienced in applying inflation accounting in the 1970s	The problems were examined based on the Sandilands Report in the UK applications	The problems with inflation accounting related to the state administration, economic institutions, and other institutions are discussed
2002	Abitter Özulucan	It is aimed to examine the inflation accounting method within the scope of the specified standards	Information about the general level of the prices accounting model is given	Communiqués have been determined, and measures to be taken against the events during the transition to inflation accounting have been decided
2002	Abitter Özulucan	It is aimed to obtain information about the self-financing methods and inflation accounting practices currently used by certified public accountants, certified public accountants, and certified public accountants operating in Turkey	The data set was created utilizing a questionnaire	Suggestions are given about measures to take during the transition to inflation accounting
2004	Ömer Tekşen and Serdar Atay	It is aimed to examine the effects of the inflation accounting system on the financial statements in an inflationary economy based on tax law	Tax Procedure Law No. 5024 has been examined regarding inflation accounting	Suggestions were made about the application forms of inflation accounting
2004	Fikret Çankaya and Engin Dinç	Law No. 5024 aims to reveal the problems that may arise from the inflation accounting system, which will be implemented for the first time on a larger scale	Tax Procedure Law No. 5024 has been examined in terms of inflation accounting	Possible problems were identified, and a discussion environment was created
2004	Hüseyin İleri and İsa Altınışık	It examines the necessity of adjusting inflation in an inflationary environment and the problems experienced in applying inflation accounting models	The data set was created utilizing a questionnaire	The necessity of the inflation correction system in terms of use has been examined, and the benefits of use have been revealed
2005	Turgut Özkan	The study is aimed to measure the dimensions of the events that occur in the financial status of the companies in the post-adjustment period compared to the pre-inflation adjustment period	In addition to all theoretical studies up to the year the study was conducted, periodic financial ratio analyses of companies traded on the ISE (Istanbul Stock Exchange) and which publish financial statements suitable for comparison are made, testing the changes in the classified ratios after inflation adjustment, and general trends occurring with inflation adjustment are revealed	After applying inflation accounting, the absolute market values of the items in the financial statements are not obtained. However, it has been concluded that the inflation accounting adjustment gives a more meaningful result than the partial adjustment still applied

(*Continued*)

Table 3.
Studies on Inflation Accounting (Continued)

Workıng Year	Author/ Authors	Purpose of the Study	Method	Conclusıon
2005	Fehmi Karasioğlu and Namık Kemal Erdemir	In our country, it aims to explain the correction procedures that practitioners should do and examine the adjustments to be made for the transition period. The following period, by giving examples, is within the scope of the law numbered 5024, which is based on the IAS-29: Financial Reporting Standard in Hyper-Inflationary Economies and TAS-2 (Turkish Accounting Standards): Financial Reporting Standard in High Inflation Periods	I was giving an example on the subject	The effects of inflation, which has more than one adverse effect, on businesses have been revealed
2005	Nusret Kurdoğlu	It is aimed to explain by giving an example of the record of inflation accounting	I am giving an example on the subject	How to record inflation accounting is shown in detail
2005	Hakan Erkuş	It is aimed to give information about the correction records to be made within the framework of the regulations taking place before and after the inflation accounting on the subject of depreciation	Various laws, communiqués, and regulations regarding depreciation in the circular have been examined	Arrangements in depreciation records according to inflation accounting regulations have been examined in detail
2005	Çağrı Köroğlu and Tuğba Uçma	It is aimed to give information about the applicability of inflation accounting in Turkey	An example was given on the subject, and information was provided	An examination was made of the applicability of inflation accounting
2006	Serap Açık	This study examines how price fluctuations affect businesses and the inflation accounting methods that will minimize these effects	Examination of legal regulations	The legal regulations published in Turkey on inflation accounting were examined
2007	Fevzi Serkan Özdemir and Seçkin Arslan	Inflation correction methods can be classified in various ways; There are four methods: traditional accounting, general price-level accounting, current price-level accounting, and mixed mode. The study aimed to investigate the similarities and differences between the methods	I am examining the comparisons related to the subject	Inflation correction methods were examined in detail in terms of similarities and differences
2009	Aylin Poroy Arsoy and Ümit Gücenme	It is aimed to reveal the effects of inflation on companies in Turkey and what companies did to protect themselves from the impact of inflation until 2003	Companies were analyzed by examining inflation rates	The effects of inflation accounting on companies are examined by comparing the Ministry of Finance and the Capital Markets Board regulations regarding inflation adjustment
2018	Fehmi Yıldız	The application of inflation accounting aims to examine how it affects enterprises' balance sheets and income statements	Information on the subject has been given	Suggestions were made regarding the necessity of applying inflation accounting in Turkey
2021	Odey Innocent Oko, Inyang Inyang Ochi, Oni Timothy Oluwatominiyi, Ahakiri Francis Idiege, and Ebaye Theresa	It is aimed to examine the effects of price increases in Nigeria on financial affairs	The data set was created utilizing a questionnaire	The results revealed that the rate of price increase has an undesirable and intangible relationship with an actual gross domestic product, and money supply has a positive but insignificant relationship with the natural gross domestic product
2022	Naim Varol	It aims to determine the deficiencies by examining the application of inflation accounting in tax legislation and accounting standards	A literature review was conducted on the subject	The inadequacies in the inflation accounting application were determined, and solutions were suggested

Note: IAS = International Accounting Standards.

ABC Commercial Enterprise 2003 Income Statement

Gross Sales		
(Returns and discounts)		
Net sales		
(Cost of sales)		
Gross profit (loss) on sales		
Operating expenses		(2,500,000)
(General and administrative expenses)	(1,500,000)	
(Depreciations)	(1,000,000)	
Operating profit (loss)		(2,500,000)

The balance sheet of ABC's trading business dated December 31, 2003, will be as follows, together with the transfer of the net loss in the income statement for the 2003 operating period to the balance sheet.

ABC Trading Company Balance Sheet dated December 31, 2003

I Current Assets		1,500,000
1 Cash	1,500,000	
II Fixed Assets		
1 Fixtures		3,000,000
2 Accumulated	5,000,000	
Depreciation	(2,000,000)	
Assets Total		4,500,000
III Short-Term Foreign Resource		
IV Long-Term Foreign Resource		
V Equity	10,000,000	4,500,000
1 Capital	(3,000,000)	
2 Previous Years Loss	(2,500,000)	
3 Period Loss		
Passive Total		4,500,000

Steps to be followed to adjust the balance sheet of ABC trading business dated December 31, 2003, by Law No. 5024 and related communiqués:

Step 1:

According to the law, the first step in inflation correction is using the list of financial accounts—non-monetary accounts in Annex-1 and Annex-2 of the General Communiqué No. 328 of VUK; the funds in the balance sheet dated December 31, 2003, will be arranged accordingly.

Since monetary accounts, after this separation, are expressed with their current values at the balance sheet date, they will not be adjusted and will remain the same (i.e., the adjustment coefficient will be 1); non-monetary accounts, on the other hand, will be corrected by multiplying the correction coefficients (Annex-5 of the General Communiqué No. 328 of TPL) as of the relevant dates. In addition, some accounts (by Communiqué No. 328) will not be corrected or deleted from the balance sheet (i.e., their amounts will be reset).

Step 2:

The second stage in inflation adjustment is the correction of non-monetary accounts.

- Fixing fixtures

Index for June 2002: 1.324486

5,000,000 × 1,32486 = 6,624,300

Inflation difference = 6,624,300 – 5,000,000 = 624,300

- Adjustment of accumulated depreciation

2,000,000 × 1,32486 = 2,649,720

Inflation difference = 2,649,720 – 2,000,000 = 649,720

Communiqué No. 328 stipulated that a separate procedure would be applied to correct accumulated depreciation in the balance sheets dated December 31, 2003. The accumulated depreciation in the balance sheet dated December 31, 2003, will be rectified after the related fixed assets are adjusted, taking into account the increased coefficient of the fixed assets.

$$\text{Coefficient of Increase:} \frac{\text{Adjusted Amount of Fixed Related Asset}}{\text{Balance Sheet Value of Related Fixed Asset dated 31.12.2003}}$$

In the example, since there is no revaluation fund in the balance sheet value of the fixed asset dated December 31, 2003, the fixed asset's correction coefficient (increase rate) of the accumulated depreciation is equal.

- Capital adjustment

In the example, since the capital is collected in cash, it is corrected with the correction coefficient of the collection date (May 2002).

10,000,000 × 1.34015 = 13,401,500

Inflation difference = 13,401,500 – 10,000,000 = 3,401,500

Step 3:

The third step in inflation adjustment is to prepare the corrected balance sheet by making the amounts of the monetary

accounts the same, the pieces of the non-monetary funds updated, and resetting the reports to be deleted from the balance sheet. After these transactions, retained years' profits or previous years' losses account is used in the liabilities to ensure the balance of assets and liabilities in the adjusted balance sheet. It is stated in Law No. 5024 that the earned earnings to be found will not be subject to tax, and the loss of the past years will not be deducted from the tax base.

To ensure the corrected assets and liabilities equivalence in the sample enterprise, a negative number should be added to the liability side, seen in the adjusted balance sheet as 7,926,920 TL as past years' loss.

ABC Trading Company Adjusted Balance Sheet dated December 31, 2003

I Current Assets		1,500,000
1 Cash	1,500,000	
II Fixed Assets		
1 Fixtures		3,974,580
2 Accumulated Depreciation	6,624,300 (2,649,720)	
Assets Total		5,474,580
III Short-Term Foreign Resource		
IV Long-Term Foreign Resource		5,474,580
V Equity	10,000,000	
1 Capital	(3,401,500)	
2 Capital Adjustment Positive Difference	(7,926,920)	
3 Previous Years' Loss		
Passive Total		5,474,580

Step 4:

The fourth step in inflation adjustment is to make accounting entries for the adjustments.

1	698 Inflation adjustment calculation 580 Previous years' losses 591 Period loss	5,500,000	 3,000,000 2,500,000
2	255 Fixed assets 698 Inflation adjustment calculation	1,624,300	 1,624,300
3	698 Inflation adjustment calculation 257 Accumulated depreciation 502 Capital adjustment positive difference	4,051,220	 649,720 3,401,500
4	580 Adjusted retained losses 698 Inflation adjustment calculation	7,926,920	 7,926,920

DEBT	698 INFLATION CORRECTION ACCOUNT	WILL RECEIVE
5,500,000 (1)		1,624,300 (2)
4,051,220 (3)		
9,051,220		1,624,300

Adjusted Prior Year Loss: 9,051,220 - 1,624,300 = 7,926,920

Conclusion

Inflation accounting is a specialized technique used in some parts of the world to consider the impact of rising or falling costs of goods on the reported figures of international companies. Financial statements are adjusted based on price indices rather than cost accounting to give a clearer picture of a firm's financial condition in inflationary environments. This method is sometimes called price-level accounting.

If an entity operates in a country with substantial price inflation or deflation, the financial and non-financial information contained in that entity's financial statements is no longer valid. To solve the problem in this situation, in some cases, businesses need to use figures adjusted for inflation rates, which are revalued to reflect the current economic reality.

The International Accounting Standard-29, adopted by the International Financial Reporting Standards, guides businesses using the currency of a hyperinflationary economy. Hyperinflation by IFRS is defined as prices, interest, and fees based on a price index that increases by 100% or more cumulatively over 3 years. Therefore, for companies in this category to adapt their financial statements to the current economic conditions, updated information must be added according to the adjusted price-level and cost-based financial statements (What Is Inflation Accounting?–https://www.investopedia.com/terms/i/inflation-accounting.asp, accessed date: January 9, 2023).

Inflation accounting can both benefit and harm businesses. The main benefit is that the corrected and presented figures are valuable to stakeholders using financial information. In addition, it adds value to stakeholders operating the financial information in the financial statements when comparing data in a company's past financial statements. For example, suppose inflation or deflation in the economy is substantial. In that case, difficulties are experienced in comparing current revenues with historical costs in the same period; in this case, inflation accounting greatly benefits stakeholders.

Contrary to all these benefits, inflation accounting can complicate the financial statements during the application phase of the financial statements and cause difficulties for the stakeholders who benefit from the information in these statements

to understand what the figures in the reports mean. It can also pose a moral problem for companies that try to mislead stakeholders by using this complexity in their financial statements. In addition, it can lead to multiple opinions and financial statements that are constantly modified (Benefits and Drawbacks - https://corporatefinanceinstitute.com/resources/knowledge/accounting/inflation-accounting/, accessed date: January 14, 2023).

Inflation accounting came to the fore years after the November 2021 inflation data, which signaled a high inflation process in our country, were announced. When the December 2021 inflation data were reported, the talk of inflation accounting practices gained momentum, and businesses started to see that inflation accounting would indeed be applied. However, there were many question marks regarding the implementation because it was possible to evaluate voluntarily by revaluation according to Law No. 7326. The implementation period expired on December 31, 2021, and Law 7338 provides an indefinite valuation opportunity. In this process, he made inflation accounting the most discussed topic in the business world.

The Ministry of Treasury and Finance shared with the public the draft communiqué it prepared to guide inflation accounting practices, as the conditions required for implementing inflation accounting have emerged. However, TÜRMOB did not want the application of inflation accounting because it would increase professionals' workload. He accepted this reasoning as a basis and demanded that the implementation of inflation accounting be postponed in the official sense. Therefore, while the Ministry of Finance wanted to implement inflation accounting and was publishing the draft communiqué, TÜRMOB was making an official request to postpone the implementation.

If inflation accounting is not applied, businesses must make revaluation transactions using the provisions of Law No. 7338. In addition, they will pay around 2% tax on the value increases of the assets related to this transaction. A surcharge of about 2% should also be accepted by the Ministry of Finance when the economy is still not viable after the pandemic and increases in public revenues are needed. With the law proposal submitted to the Presidency of the Turkish Grand National Assembly on January 13, 2022, inflation has been proposed to postpone the accounting application to 2023 (https://www.dunya.com/kose-yazisi/beklenen-son-enflasyon-muhasebesi ertelendi/646040#:~:text=13.01.2022%20tarihinde%20TBMM%20Ba%C5%9Fkanl%C4%B1%C4%9F%C4%B1,muhasebesi%20uygulamas%C4%B1%202023%20y%C4%B1l%C4%B1na%20ertelenecektir). The following statements were included in the news published by the Grand National Assembly of Turkey:

> "According to the Bill on Amending the Tax Procedure Law and the Corporate Tax Law, financial statements are subject to inflation adjustment regardless of whether the conditions for the inflation adjustment within the scope of the Tax Law are met in the 2021 and 2022 accounting periods and the 2023 accounting period interim tax periods, including the interim tax periods. Will not be subjected.
>
> The periods in which no inflation adjustments will be considered "the period in which the conditions for inflation adjustment are not met."

The financial statements dated December 31, 2023, will be subject to inflation adjustment regardless of whether the inflation adjustment conditions have been met.[1]

The financial information will reflect the truth if the financial statements are adjusted according to the inflation accounting application. As a result, the economic analyses will give healthier outcomes, and the decisions to be taken by businesses and stakeholders will be more realistic. As a result, financial information users will be able to provide accurate information about companies, and confidence in capital market instruments will increase (Yıldız, 2018).

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