



PRICE INDICES TO DETERMINE CURRENT VALUE FOR DEPRECIATION ADJUSTMENT : A STUDY OF SUGGESTIONS FROM INDIAN INDUSTRY

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ABSTRACT

Depreciation is normally provided on the basis of cost price of an asset which in the opinion of intellectual does not reflect the real value of an asset. That's why the value of assets needs to be adjusted to its current value. As Price indices reflect the general price level of an economy, they may be used as the basis for determining current value to make depreciation adjustments. The current study tries to get the suggestions from the respondents from Indian industry regarding the use of price indices to determine current value for depreciation adjustments.

Key Words: Price indices, current value, depreciation adjustment

Introduction

It has been universally accepted that inflation leads to the misallocation of economic resources by distorting the price levels. Confronted with a general rise in prices, people normally get confused. They are not sure whether to attribute the surging prices to a real spurt in demand, to speculation, to inflation, or to what. They often make the wrong decisions. From accounting point of view, in periods of rising prices, financial accounting information has been criticized on the grounds that it reflects the old monetary value while the value of the money is changing. According to **Hughes, Liu, and Zhang (2004)**, "Inflation creates an earnings illusion as an artifact of the mismatching of expenses based on allocations of historical costs with current revenues in determining earnings. This

mismatching distorts mappings of aggregate earnings and book values into equity value such that value-relevant information is lost.”

This also affects the provision of depreciation on fixed assets of companies. So to adjust inflation the value of assets must be converted to current value. To have current value price index may be used as one of the basis for depreciation adjustments. To make the study more relevant price indices are further classified into Wholesale Price Indices, Specific Price Index and General Price Index.

Review of Literature

Dhameja (1997) considered the different aspects of practices related to revaluation of fixed assets. He observed that there was no pattern in the frequency of asset revaluation. Most of the companies have revalued their assets once. As far as the basis of revaluation was concerned it was replacement value or current prevailing prices. Further the study considered adjustment of inflation, tax planning and influencing share prices as the practical rationale for revaluation. By making the reference of Sandilands Committee recommendations of introducing of greater standardization in revaluation approach, the author suggested to lay down a definite accounting standard on revaluation so as the accounting being business language portrays prudent financial information. **Bhat** (1999) wrote an article on "Capital Depreciation Accounting - Recognizing Current Purchasing Power." In this the author had tried to give a new version of Capital depreciation accounting in the era of changing prices. He says, " Capital depreciation accounting means valuing the capital at current purchase price and providing from the profits/financial system of the firm to bring up the capital figure to the extent of loss or erosion so incurred." Further in his views Capital depreciation accounting was an attempt to provide for the loss in the purchasing power of money which was infused into the system originally and thus restore its original value. He asserted that the assets of a company could be depreciated, as per the taxation laws and it was a cash flow. However, considering the rapid changes in technology and the rate of obsolescence, it was essential to restructure taxation provisions to be in tune with global practices, as many companies had become sick because they did not provide for modernization in conformity with world trends. He further suggested that if assets were depreciated and capital was accounted at current purchase price, there would have to be larger provisioning out of profits, which would otherwise have been taxed. By making it mandatory to improve the capital formation as equivalent to the present purchasing power, the amount that would be distributed as profits

would be retained and ploughed back into the system, thus stabilizing and strengthening the same.

Objectives of Study

Following associated objectives of study are considered:

- To study the recommendations of industry regarding preference of price index
- To analyze industry and sector wise suggestions provided by respondents regarding preference of price index

Sample size and Data

A sample of 350 companies from various industries and sectors has been selected. They have been sent questionnaires and only 61 respondents from Indian corporate sector have given their views regarding price indices.

Study

Suggestions of Price Indices

Respondents from the corporate sector in India are offered to recommend the price index, which they would favour in order to determine the current value for adjusting depreciation as regards to inflation. Under this the opinion on three price indices viz. wholesale price index, specific price index and general price index, has been demanded from corporate sector in India. 65.57 percent, who have declined to suggest are shown under head “No Comments” in the Table 1. Further there are 16.39 percent of respondents who have skipped the question by simply saying “Not applicable” since they have already opted for value determined by technical experts and/or manufacturer’s or supplier’s price list.

Industry wise analysis reflects that 50 percent of respondents from steel and 11.11 percent from electronics and engineering industries have voted in favour of wholesale price index whereas chemical, textiles and diversified and other industries have outrightly rejected wholesale price index. Chemical industry (22.22 percent) and electronics and engineering industries (16.67 percent) are settled upon specific price index while respondents from steel, textile industries and diversified and other industries have discarded specific price index as no one has suggested this index. No respondent from any industry backs the use of general price index for ascertaining current value. (refer Table 1)

Sector wise analysis as reflected by Table 2 depicts that that specific price index (33.33 percent) has been more recommended than wholesale price index (16.67 percent) by respondents in public sector companies in India. For general price index public sector said

NO. Respondents from foreign subsidiaries in India expressed that only specific price index is useful for calculating current value as they have rejected wholesale price index and general price index totally. Wholesale price index (6.98 percent) and specific price index (4.66 percent) are the choice number one and two in private sector Indian companies. An important fact appears that general price index has not got any accommodation from any sector. So in brief it has been emerged that specific price index is the favored price index by respondents from corporate sector in India.

Findings

- 16.39 percent of respondents are already using the values as determined by technical experts and/or manufacturer's or supplier's price list.
- Industry wise analysis depicts that 50 percent of respondents from steel and 11.11 percent from electronics and engineering industries have favoured the use of wholesale price index rest of respondents from chemical, textiles and diversified and other industries are not in favour of wholesale price index.
- No respondent from any industry suggests the use of general price index for ascertaining current value.
- One third of respondents from the public sector recommend the use of specific price index whereas one sixth of respondents have recommended wholesale price index.
- General price index seems to be non preferable in public sector.
- Respondents from foreign subsidiaries in India prefer specific price index only for calculating current value.
- Not even single respondents from foreign subsidiaries in India have favored wholesale price index and general price index.
- Respondents from private sector Indian companies' have suggested that wholesale price index is more preferable than specific price index.
- An important fact appears that general price index has not got any accommodation from any sector.
- So in brief it has been emerged that specific price index is the favored price index by respondents from corporate sector in India.

TABLE 1

**Industry wise Analysis of Suggestion of Price Indices to Determine Current Value
for Depreciation Adjustment.**

Recommended Price Indices	INDUSTRY					<u>Total</u>
	Chemicals	Electronics & Engineering	Steel	Textiles	Diversified & Others	
a) Wholesale Price Indices	0	2(11.11)	2(50)	0	0	4(6.56)
b) Specific Price Index	4(22.22)	3(16.67)	0	0	0	7(11.48)
c) General Price Index	0	0	0	0	0	0
d) No comments	9(50)	12(66.67)	2(50)	3(75)	14(82.36)	40(65.57)
e) Not Applicable	5(27.78)	1(5.56)	0	1(25)	3(17.64)	10(16.39)
f) TOTAL	18	18	4	4	17	61

Source: Compiled from Questionnaire

TABLE 2

**Sector wise Analysis of Suggestion of Price Indices to Determine Current Value for
Depreciation Adjustment.**

Recommended Price Indices	SECTOR			<u>Total</u>
	PUBLIC (Government Companies)	PRIVATE		
		Foreign subsidiaries	Indian (Domestic companies)	
a) Wholesale Price Indices	1(16.67)	0	3(6.98)	4

b) Specific Price Index	2(33.33)	3(25)	2(4.66)	7
c) General Price Index	0	0	0	0
d) No comments	3(50)	5(41.67)	32(74.41)	40
e) Not Applicable	0	4(33.33)	6(13.95)	10
TOTAL	6	12	43	61

Source: Compiled from Questionnaire

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