

## **AN ANALYSIS OF THE IMPACT OF INFLATION ON THE FINANCIAL AND ECONOMIC ACTIVITIES OF COMMERCIAL ORGANISATIONS**

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**Abstract:** The article discusses the methodology of adjusting the indicators of financial and accounting reporting used for assessing the activities of commercial organisations in the context of inflation. This is extremely important for increasing the validity of management decisions. The calculations have been performed on the basis of a particular example of a functioning organisation.

**Keywords:** assessment, impact of inflation, adjustment of financial indicators, monetary and non-monetary balance sheet items, financial results.

**JEL:** G30.

Ensuring the sustainable dynamics of the socially oriented economic development determines the necessity of using effectively the potential of all economic subjects. In the process of managing modern companies, it is important to take into account the interconnectedness and interaction of the procedural, technological and resource components of this process. This will facilitate the achievement of the set long – term development goals of the trade companies and will guarantee the

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significance, sustainability and adequacy of their operations based on the accumulated potential, level of resource utilization and competitiveness.

It must be noted that the results of management activities are, as a rule, assessed by the subject of management in accordance with their own internal criteria while the elements of the external environment (including the object of management) are assessed according to their own criteria, which are external to the business system. The concept of assessment is used from two perspectives, namely as an immediate result of certain measurements and as a process. The assessment process involves a description of the current state of the economic agents with the help of multiple indicators measured in certain measurement scales. The effectiveness of this process is analysed on the basis of certain criteria. The assessments (the assessment viewed as a result) of these criteria are also measured in the respective measurement scales.<sup>2</sup> The assessment process suggests a transition from the premises of the economic system state to criteria – based premises, that is the process implies determining a dependence between the assessment values according to certain criteria and the indicator values used for describing the system's state (in certain cases the criteria can coincide with the indicators).<sup>3</sup> Therefore, the choice of indicators must be determined by the purposes of the evaluation.

In the system for assessing the results of the production, commercial and financial activities of the trading companies, the profit-related indicators have a summative nature. In turn, the magnitude of the profit is determined by the volume of sales, (work performed, services offered, etc.), the level of incurred costs and the inflation processes.

Inflation considerably reduces the economic potential of organisations because writing materials and supplies as costs in low purchasing prices, the small depreciation costs of the basic own funds and the intangible assets lead to the formation of inflationary excess profit and

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<sup>2</sup> See: **Novikov**, D. A. Metodologiya upravleniya / D.A. Novikov. - M.:Librokom, 2011, ,p. 128.

<sup>3</sup> See: **Novikov**, D. A. Metodologiya upravleniya / D.A. Novikov. - M.:Librokom, 2011, ,p. 128.

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this favours the making of increased tax payments. If money loses its purchasing power at high rates, the comparison of the amounts received after performing the business operations even within the scope of one reporting period will mislead the users of the financial reports. Therefore, when the inflation rates are high, the accounting reports for the organisation that are prepared by using the financial results for the particular reporting period must be adjusted to the inflation rates.

According to official data, the inflation rate in the Russian Federation for 2013 was 6,5%. For 2014 it was 11,35% and 12,91% for 2015 while for 2016 the forecast was for 10,4%<sup>4</sup>, which is a sign of creeping inflation.

Inflation is characterised by the consumer price index (CPI), which is calculated and published by the Federal State Statistics Service of the Russian Federation. The CPI is one of the price indexes used by economists to measure the average level of the prices of products and services included in the consumer basket for a particular period.

Assessing the impact of inflation on the conditions and results of the business activities of trade organisations must start by dividing the balance sheet items (BSI) into two groups, namely monetary and non-monetary balance sheet items. An important feature of the monetary balance sheet items is the fact that they are not adjusted when the impact of inflation is assessed because they already reflect the current prices as of the date of preparing the accounting reports. Their adjustment, however, is accomplished by taking into account the changes in the price index, which is applied to their balance sheet value as of the purchase date or as of the assessment date, etc.<sup>5</sup> This classification of the balance sheet items is presented in Table 1.

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<sup>4</sup> Ofitsialnoi sait Federalnoy sluzhbi gosudarstvennoy statistiki RF // [Elektronniy resurs] // Rezhim dostupa : <http://www.gks.ru>.

<sup>5</sup> **Endovitskiy**, D. A. Otsenka vliyaniya inflyatsii na finansovie rezultati deyatelnosti kommercheskoi organizatsii / D.A. Endovitskiy // Auditor, – 2011. – №2 – p. 23.

**Table 1**

*A list of the monetary and non – monetary assets and liabilities of the trade organisation (according to data from the organisation’s balance sheet)*

Assets	Liabilities
Monetary	
1. Cash holdings (including current accounts, foreign currency accounts and other funds)	1. Long – term liabilities (chapter 4)
2. Receivables from debtors (buyers and clients, bills receivable, contributions to the equity capital payable by owners, other debtors)	2. Short – term credits and loans
3. Financial investments (apart from monetary equivalents )	3. Obligations to creditors (suppliers and entrepreneurs; bills payable; obligations to the subsidiaries and the other dependable organisations; obligations arising from paying staff wages and work done; obligations to the state non-budget funds, the budget and other creditors)
Non – monetary	
1. Intangible assets	1. Capital and reserves
2. Basic own funds	
3. Profitable investments in tangible assets	
4. Long – term and short – term share capital instruments	
6. Reserves	
7. Value added tax on acquired tangible assets	

We will study the inflation impact on the financial results of the OOD NPF “AIV”, which is a scientific production company that operates in the sphere of wholesale trade with computers and peripheral devices. Table 2 presents the dynamics of the monetary assets and monetary liabilities of the company for the period 2013 – 2015 based on the company’s accounting reports.

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*Table 2*  
*Dynamics of the monetary assets and liabilities of OOD NPF "AIV" for the period 2013–2015 (in thousand RUB)*

Assets	Year			Deviation for 2015 as compared to 2013	
	2013	2014	2015	Absolute values in thousand RUB	Growth rate, %
1. Cash holdings	49	9	0	-49	-
2. Receivables from debtors	1200	3033	8761	+7561	в 7,3 p.
3. Monetary financial assets	-	-	-	-	-
Total monetary assets (ПА)	1249	3042	8761	+7512	в 7,0 p.
Liabilities					
1. Long – term liabilities	-	-	-	-	-
2. Short – term credits and loans	1000	1000	1000	-	100,0
3. Obligations to creditors	4621	4544	8090	+3469	175,1
4. Obligations for wage costs and work performed	-	-	-	-	-
Total monetary liabilities (ПП)	5621	5544	9090	+3469	161,7
The currency of the balance	9090	9073	12643	+3553	139,1

The non – monetary balance sheet items of the analysed company are presented in Table 3.

*Table 3*  
*Dynamics of the non – monetary assets and liabilities of OOD NPF "AIV" for the period 2013–2015 (in thousand RUB)*

Assets	Year			Deviation for 2015 as compared to 2013	
	2013	2014	2015	Absolute values in thousand RUB	Growth rate, %
1. Intangible assets	15	15	0	-15	0,0
2. Basic own funds	66	66	0	-66	0,0
3. Unfinished construction works	-	-	-	-	-
4. Profitable investments in tangible assets	-	-	-	-	-
5. Long – term and short – term financial instruments	-	-	-	-	-
6. Reserves	7680	5870	3882	-3798	50,5
7. VAT	-	-	-	-	-
8. Advance payments made	-	-	-	-	-
Total non – monetary assets (НПА)	7841	6031	3882	-3959	49,5

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Liabilities					
1. Capital and reserves	3469	3529	3553	+84	102,4
2. Advance payments received	-	-	-	-	-
3. Incomes for future periods	-	-	-	-	-
4. Reserves for future expenses	-	-	-	-	-
Total non – monetary liabilities (НПП)	3469	3529	3553	+84	102,4
Currency of the balance sheet	9090	9073	12643	+3553	139,1

In the process of analysing the impact of inflation on the final results of the organization, we calculate the values of the following indicators:<sup>6</sup>

$$K_1 = \text{ПА}/A, \quad (1)$$

$$K_2 = \text{ПП}/\Pi, \quad (2)$$

$$K_3 = \text{ПА}/\text{ПП}, \quad (3)$$

where  $K_1$  is the relative share of the monetary assets in the currency of the balance sheet;

$K_2$  is the relative share of the monetary liabilities represented in the currency of the balance sheet;

$K_3$  is the ratio of the monetary assets and monetary liabilities of the organisation;

ПА and ПП are values which refer to the monetary assets and monetary liabilities respectively;

A and Π are the values of the assets and liabilities (the currency of the balance).

Table 4 presents an analysis of the dynamics of these indicators for OOD NPF “AIV” according to the results for the period 2013 – 2015.

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<sup>6</sup> See: **Goloshchapova**, L. V. Analiz vliyaniya inflatsii na finansovie rezultati / D.A., Makeicheva, A.A. Pavlova [Elektronniy resurs] //XXIV Studencheskaya mezhdunarodnaya zaochnaya nauchno – prachiticheskaya konferentsiya “Molodezhniy nauchniy forum: Obshchestvenie I ekonomicheskie nauki” Rezhim dostupa: <http://nauchforum.ru/en/node/7391>

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*Table 4  
Dynamics of the indicators used for analysing the impact of inflation  
on the results from the financial and economic activities  
of OOD NPF "AIV" for the period 2013 –2015*

Indicator	Symbol	Year			Deviation	
		2013	2014	2015	2015 compared to 2014 (+,-)	2015 compared to 2013 (+,-)
1. Monetary assets, thousand RUB	ПА	1249	3042	8761	+5719	+7512
2. Monetary liabilities, thousand RUB	ПП	5621	5544	9090	+3546	+3469
3. Currency of the balance sheet, thousand RUB	А, П	9090	9073	12643	+3570	+3553
4. Relative share of the monetary assets in the currency of the balance sheet	K <sub>1</sub>	0,15	0,34	0,69	+0,35	+0,54
5. Relative share of the monetary liabilities in the currency of the balance sheet	K <sub>2</sub>	0,62	0,61	0,72	+0,11	+0,1
6. Ratio of monetary assets and monetary liabilities	K <sub>3</sub>	0,24	0,56	0,96	+0,4	+0,72

The calculations based on the materials of OOD NPF "AIV" are a proof that the value of the indicator for the relative share of the monetary assets in the currency of the balance sheet was increasing during the entire period. The value of the indicator for the share of the monetary liabilities in the currency of the balance sheet decreased in 2014 when compared to 2013 but after that went up to 0,72 in 2015. When reducing the negative effect of inflation on the financial and economic results of its activities, OOD NPF "AIV" must try to decrease the relative share of the monetary assets and to increase the relative share of the monetary liabilities in the currency of the balance sheet. What is more, we should not forget that this situation could possibly lead to increasing the risk of liquidity loss, which undoubtedly will have a negative impact on the financial state and stability of the organisation.

The indicator for the ratio of the monetary assets and liabilities characterises the general liquidity value, i.e. the organisation's capability of meeting financial obligations by using monetary assets. At the same time, this indicator reflects the possibilities of affecting the inflation effects of the final results of the financial and economic activities of trade organisations. If the value of the indicator is bigger than 1, practically all costs for the reproduction of non-current assets and filling the reserves are financed by the company's own resources. As a result, this situation has a negative impact on the net profit value of companies because the purchasing power of monetary assets is reduced.

The calculations show that the ratio of the monetary assets and monetary liabilities ( $K_3$ ) of OOD NPF "AIV" for the period 2013 – 2015 is lower than 1. This means that the costs of replacing the non – monetary assets are covered by mixed funding, i.e. using own and external resources. In this case, under conditions of inflation and as a result of reducing the share of monetary assets, the organisation maintains its purchasing power. In addition, the net profit will increase because the process of adjusting the non – monetary balance sheet items leads to hidden inflation premium. Thus, the analytical indicator ( $K_3$ ) acts as a specific inflation leverage and the changes in its value can weaken (strengthen) the financial position of the company and at the same time to increase (decrease) its resistance to the negative effects of inflation. For the studied company, the value of this indicator increased by 73%. This proves that the management of OOD NPF "AIV" are very careful when they use borrowed capital to finance the costs of filling the reserves and replacing the non – current assets, which is a positive sign under the conditions of high inflation.

After forming the two groups of monetary and non – monetary balance sheet items, the balance of the increase (decrease) in the assets and liabilities values of the organisation for the period is:

$$\Delta \text{ПА} + \Delta \text{НПА} = \Delta \text{ПП} + \Delta \text{НПП} , \quad (4)$$

where  $\Delta$  is the change in the indicator value (increase or decrease).

During the process of analysing the inflation impact on the results of trade companies, it is appropriate to create a balance model of the



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increase (decrease) in the company's assets and liabilities by taking inflation into account.

In order to make a quantitative assessment of the inflation impact on the financial results of the company, we consider that it is appropriate to use the concept of preserving the financial capital, which is outlined in the principles for preparation and presentation of financial statements in accordance with International Financial Reporting Standards (IFRS).<sup>7</sup>

According to this concept, the financial result is defined as a change (increase or decrease) in the value of capital, expressed in nominal monetary units. Based on this definition, a positive financial result (profit) is the increase in the company's own capital during the reporting year except for funds distributed among the owners (paid dividends) and the results from the capital operations. In order to assess the impact of inflation on the financial results of the trade companies, it is appropriate to use the indicator for the common value of inflation (i) used for repeated assessment of the non – monetary balance sheet items. Taking into account the above - mentioned, the adjusted balance model of the increase (decrease) in the company's assets and liabilities will be as follows:

The initial data for assessing the inflation impact on the financial result based on the concept of preserving financial capital are outlined in Table 5.

*Table 5*  
*Initial data for analysing the increase (decrease) in the assets and liabilities of the organisation in thousand RUB*

Indicator	Symbol	Asset	Symbol	Liability
1. Non – monetary balance sheet items	ΔНПА	-3959	ΔНПП	+84
2. Monetary balance sheet items	ΔПА	<b>7512</b>	ΔПП	+3469
3. Change in the currency of the balance sheet	ΔА	3553	ΔП	3553

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<sup>7</sup> See: **Barabanov**, A. Mezhdunarodnie standarti finansovoi otchetnosti – Obzor [Elektonniy resurs] // Korporativniy menedzhment. Rezhim dostupa: <http://www.cfin.ru/ias/overview-3.shtml>

The adjustment of the monetary indicators through determining the level of their depreciation under conditions of inflation is a means of assessing the inflation impact on the financial results of the company. Here we will assess:

- The degree of devaluation of monetary assets;
- The change in volume of the other expenditures in the part for increase (decrease) in the interest payments from the monetary liabilities balance sheet items under conditions of inflation;
- The size of inflationary profit (loss) arising due to a change in the ratio of monetary assets and monetary liabilities.

The devaluation of the monetary assets leads to hidden inflationary loss, which is determined by the fact that the ruble loses its purchasing power. As a result, the quality of the profit decreases.

When adjusting the monetary indicators, the balance of the increase (decrease) in the company's assets and liabilities for the particular period will change when we take into account inflation:

$$\Delta\Pi A + \Delta H\Pi A * (1 + i) = \Delta\Pi\Pi + \Delta H\Pi\Pi * (1 + i) + [i * (\Delta\Pi\Pi - \Delta\Pi A)], [4] \quad (5)$$

The general value of inflation for the studied period is:

$$i = (6,5 + 11,35 + 12,91) / 3 = 10,25\%.$$

The above – mentioned model (5) permits economists to assess the balance of the increase (decrease) in the company's assets and liabilities by taking into account the adjustment of the balance sheet items based on the analysis of the impact of the specific indicators. The calculations performed by using the initial data from Tables 2 – 5 are presented in Table 6.

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*Table 6*  
*Factor analysis of the inflation impact on the final results*  
*from the organisation's activity*

Calculation method	Factor	Calculation formula	Calculation result	Factor impact in thousand RUB
1st method – based on the adjustment of the non – monetary assets	Change in non – monetary assets by taking inflation into account	$\Delta \text{H}\Pi\text{A} * (1 + i)$	-3959* 1,1	-4354,9
	Change in non – monetary assets	$\Delta \text{H}\Pi\text{A}$	-3959	-3959
	Additional inflationary profit (loss)	$\Delta \text{H}\Pi\text{A} * (1 + i) - \Delta \text{H}\Pi\text{A}$	-4354,9 +3959	-395,9
2 <sup>nd</sup> method – based on the adjustment of the non – monetary liabilities	Change in non – monetary liabilities by taking inflation into account	$\Delta \text{H}\Pi\text{П} * (1 + i)$	3469*1,1	3815,9
	Change in non – monetary liabilities	$\Delta \text{H}\Pi\text{П}$	3469	3469
	Inflation leverage	$i * (\Delta \text{П}\text{A} - \Delta \text{П}\text{П})$	1,1*(7512-3469)	4794,2
	Additional inflationary profit (loss)	$\Delta \text{H}\Pi\text{П}*(1 + i) - \Delta \text{H}\Pi\text{П} + i * (\Delta \text{П}\text{A} - \Delta \text{П}\text{П})$	3815,9-3469+4794,2	5141,1

The calculation obtained through the first method shows that, as a result of the adjustment of the non – monetary assets by taking into account inflation, there is a possibility of additional inflationary loss incurred amounting to – 359,9 thousand RUB. This loss would lead to a reduction in the currency of the balance.

The calculations obtained through the 2<sup>nd</sup> method show that the most important factor is the inflation leverage (4794,2 thousand RUB) while the final impact of the three factors on the additional inflationary profit amounts to 5141,1 thousand RUB.

In the process of analysing the hidden and actual losses of the monetary indicators devaluation, we should keep in mind the fact that the monetary assets and liabilities do not incur simultaneously at the end of the reporting period. Based on this and with the purpose of ensuring the objectivity of the assessment results, it is necessary to assume the uniform emergence of monetary assets and monetary liabilities during the reporting period. What is more, it is recommended to use a ½ average inflation rate at the end of the reporting period with these indicators of the inflation component.

When planning the future activities of the trade organisation, it is necessary to assess the financial results from future periods by taking into account the possible losses resulting from inflation. To adjust the balance sheet items for the financial results based on the inflation rate seems important because it permits making conclusions about the availability or lack of dynamics in the company's development. In this case, development means an increase in sales revenues [1]. The analysis of the inflation impact on the financial results of OOD NPF "AIV" is shown in Table 7.

*Table 7*  
*Analysis of the inflation impact on the financial results of OOD NPF "AIV" for the period 2014-2015*

Indicator	Year		Change (+/-)	Growth rate, %
	2014	2015		
Indicator values in current prices				
Revenues from selling products, services, work, production in thousand RUB	162853	1327	-161526	0,8
Net profit for the accounting period in thousand RUB	60	24	-36	40,0
Profitability of sales, %	5,564	1,484	+1,77	x
Indicator presenting the cumulative increase in inflation	1,15	1,19	+0,04	103,5
Indicator value by taking into account inflation				
Revenues from selling products, services, work, production in thousand RUB	187280,95	1579,13	-185701,82	0,8
Net profit for the accounting period in thousand RUB	69	28,56	-40,44	41,4
Profitability of sales, %	0,037	1,809	+1,772	x

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The analysis results reveal that the growth rate of the OOD NPF “AIV” revenues without taking inflation into account for the period 2014–2015 was 0,81%. If inflation is taken into account, the value of growth rate was 0,84%. The net profit without considering the inflation level went down from 60 thousand RUB in 2014 to 24 thousand RUB in 2015, which is a reduction of 36 thousand Rub or 40%.

These trends (provided we rely on the data from the accounting reporting) reveal the unsatisfactory dynamics of the financial results of the analysed company during the studied period. Based on the inflation rates, the value of this indicator is even worse. The growth rate of the net profit for the period 2014–2015 was 41,4%.

It should be said that the sales profitability of OOD NPF “AIV” for the period 2014–2015 increased by 1,77% despite the general unfavourable situation. The diagrams in Figures 1 and 2 show the dynamics of the sales and net profit of OOD NPF “AIV” for the period 2014–2015 in current and comparable prices.

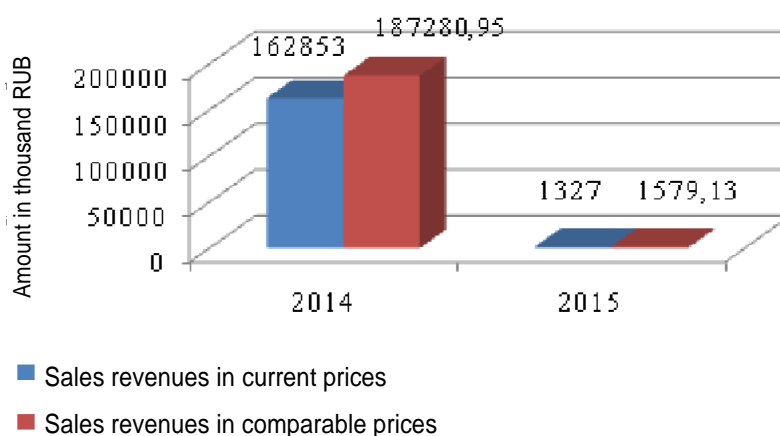
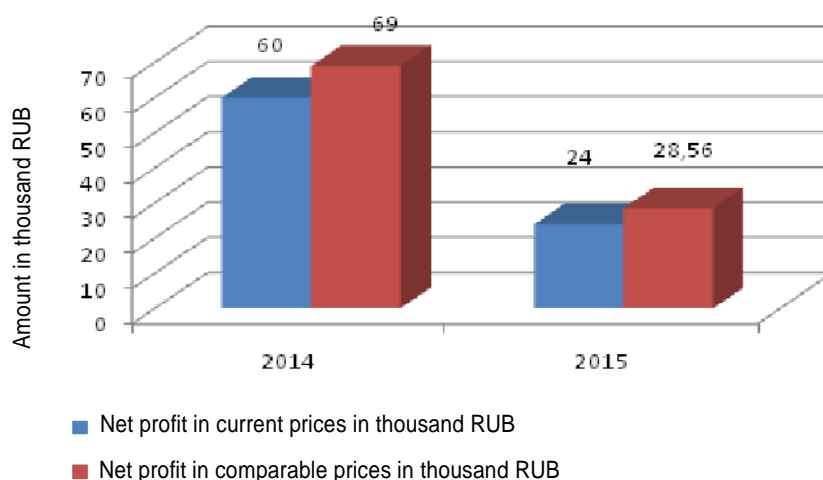


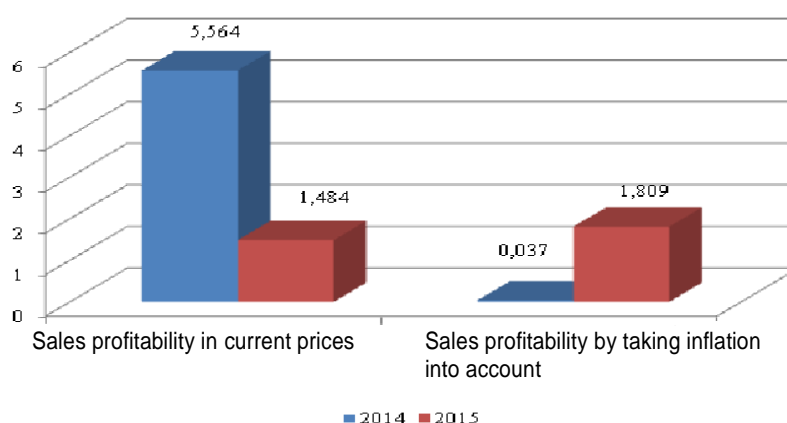
Figure 1. Sales dynamics of OOD NPF “AIV” in current and comparable prices for the period 2014–2015



*Figure 2. Dynamics of the net profit of OOD NPF "AIV" in current and comparable prices for the period 2014 – 2015*

The materials offered illustrate the fact that during the studied period the sales of OOD NPF "AIV" decreased. The growth rates, however, differ significantly if we take into account the current and comparable prices. Based on this, the diagram of the net profit dynamics reveals a short increase in costs. What is more, in 2015 the net profit went down compared to 2014.

An important indicator for the company's effectiveness is the profitability of its sales. The analysis of this indicator allows us to assess the company's capability of making profits by utilizing the invested capital. In general, profitability means collecting revenues and making profits. A company is considered profitable if the revenues from the sales of products and services cover the production costs (turnover) and generate sufficient profits that will permit its unproblematic functioning. Profitability is calculated as a ratio of net profit and the revenues and characterises the effectiveness of the entrepreneurial activities.



*Figure 3. Sales profitability of OOD NPF “AIV” for the period 2014 – 2015*

If sales profitability decreases, this can be caused by either the increased costs or the increased tax rates. In the case of OOD NPF “AIV”, both the production and sales costs were high. The reduction in the sales volumes could be a sign mainly of the lowered competitiveness of the company’s products because they are on high demand. However, the increase in the currency of the balance sheet of OOD NPF “AIV” for the analysed period by 3553 thousand RUB and the decrease in the sales revenues by 161526 thousand RUB reveal a lack of correspondence between the data from the accounting reports and the actual financial results of the company.

The value of the main funds, intangible assets, production reserves and other property at the date of preparing the accounting reports will always be higher than at the purchase date of these assets, provided the prices of products, services and labour are constantly increasing. The bigger the distance in time between the date of acquiring the property and date of preparing the accounting reports, the bigger the decrease in the value of the trade company’s property.

Using the indicators for the initial value of the company’s property in sales, acquisitions, liquidations or privatisations can lead to serious

mistakes in the calculations and losses. The reduction in the value of depreciated property, all other things remaining equal, does not allow managers to fully create sources for its reproduction.

The reduction in the value of the depreciated property leads to decreases in the depreciation costs and this is included in calculating the production costs. The reduction in the value of the used production reserves, as well as all other services, also leads to reducing the production costs incurred. The result is a partial compensation of the current expenditures at the expense of the revenues. This does not permit the reproduction of the necessary current expenditures during the next reporting periods.

The reduction in the production costs of products, services and work determines the artificial increase in the profit, profit tax and the profitability indicators. This does not permit the objective assessment of the financial and economic results of the organisation and can mislead the users of accounting information.

Because of inflation, the debtors' indebtedness is the reason for reducing the actual revenue of the trade organisation since the time lag between the debt occurrence date and the date of its repayment leads to devaluation of the received cash. The creditors' indebtedness, on the contrary, is favourable for the organisation in case it pays by using partially devaluated monetary assets. What is more, the different benefits of the receivables from debtors and the obligations to creditors leads to deliberately withholding payments, which affects the money in circulation in general.

Thus, because of inflation, the financial accounting reports often do not permit the objective assessment of the actual value of the company's property, its financial state, monetary cash flows and results.



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