

## Inflation is under control and does not exert any impact on business decisions. Is it true?

Zilton Bartolomeu Martins<sup>a</sup>; Marisa Luciana Schwabe de Morais<sup>a</sup>; Helena Wollinger<sup>a</sup>;  
Janypher Marcela Inácio Soares<sup>a</sup>

<sup>a</sup>Universidade do Vale do Itajaí

### Article information

#### Article history

Received: October 4, 2016

Accepted: January 9, 2017

#### Keywords:

Inflation adjustment.

Inflation.

Decision-making.

Financial statement

### Abstract

This case study presents a situation in which the reader is led to reflect on the impact of inflation on Financial Statements. The central character of the case in question is Antônio Morais, a successful businessman, who, after purchasing a midsize business, has tried to “meet” his new venture, starting with detailed analysis of Financial Statements as well as precise meetings with the Department of Accounting for further information. Antônio understood that there was room to further expand his new business, but to do so, he needed reliable information to support his decisions. Then, the manager decided to hire a Public Accounting to analyze the Financial Statements of the company, and received a preliminary report of the Auditor, stating they did not contemplate, through the inflation adjustment, the effects of the loss of purchasing power of the country’s currency (inflation). The case seeks to propitiate a reflection on the impacts of inflation on Financial Statements, thus promoting the opportunity to explore concepts and correlate them with the practice. This study can be used in Undergraduate Programs in Business and Accounting, specifically in the subjects of Stock Accounting, Analysis of Financial Statements, and Financial Management.

Copyright © 2016 FEA-RP/USP. All rights reserved.

## 1. INTRODUCTION

Making decisions within the business world, by itself, is a delicate task. It is from decisions made in the present that the future of a company is being traced. Decision-making with a solid base of information — though not necessarily ensuring positive results — certainly gives the manager more confidence in the decision-making process.

This is the perception of the businessman Antônio Morais, who always sought to base his decisions on accurate and reliable information. Relying on a team that works with this same direction tends to make the task less arduous and, therefore, Antônio also considers such aspect as another determining factor for his business.

His projects — successful so far — (also) are possibly the result of these postures. If the information set is not sufficiently precise and reliable, it is reasonable to assume that the decisions made based on such information can be harmed. Another factor that always worried Antônio is inflation, in other words, the general increase of prices. Since, for being a businessman and having experienced troubled times of the Brazilian economy, he knows that this can eat away the purchasing power of the consumer, thus impacting both on entries and exits of the enterprise resources.

Antônio Morais is faced — in this case — with a situation in which the collected information (specifically accounting information) does not give him any security to make his eventual decisions. Fixing the problem — retracing the information taking into account the inflation of the period — is, thus, his starting point and, parallel to this, he needs to ensure that forthcoming information can give him the security he wants and needs.

Corresponding Author: Phone +55 (48) 3285-4449

E-mail: [ziltonmartins@univali.br](mailto:ziltonmartins@univali.br) (Z. B. Martins); [marisal@univali.br](mailto:marisal@univali.br) (M. L. S. Morais); [helena\\_wollinger@hotmail.com](mailto:helena_wollinger@hotmail.com) (H. Wollinger);

[janypher@univali.br](mailto:janypher@univali.br) (J. M. Inácio Soares).

Universidade do Vale do Itajaí - Rua João Coan, 400 - Universitário, Biguaçu, SC, CEP: 88.161-064, Brazil

But, to do so, what if another more immediate decision is required? What if, at first – when taking on his new venture –, Antônio does not receive information that reflects the reality of his business? Should he keep or replace those responsible for the generation of such information? In addition to this decision, other questions permeate Antônio's thoughts: would the possible difference of values disregarded by the Financial Statements influence the decision-making for the new enterprise? And if all of this was not enough, can the political and economic crisis of the country also affect the course of the venture?

## 2. THE SCENARIO

Antônio Morais has always been an entrepreneur with vision! Since a very young age he made decisions in a rational way, always letting his emotions aside, which gave him consciousness that he would need to focus his efforts – and resources – on businesses that could represent a good return potential.

The degree in Business assisted him in the development of skills and abilities that contributed to the efficient management of the companies he has founded. His first project in the “business world” had the providential contribution of resources of his family, but he was aware that this was an isolated fact, not leaving the possibility – in case of failure – of a new contribution. Therefore, the results – whether good or bad – would be his sole responsibility and, more than that, critical for the professional career of the young businessman.

This first venture – a shoe company called Shoes – proved to be a very promising business. As a result, six years after its foundation, Antônio Morais – aging 28 years then – was already a reasonably successful businessman.

His second project, two years later, was the creation and administration of a veterinary clinic, called Charmé Dog, originally designed to give conditions to his wife (at that time, recently graduated in Veterinary Medicine) to also venture into the labor market. The resources for this second project came from the good results produced with the growth and expansion of Shoes.

Two decades separated this moment from the current one. Today, aging 48 years, Antônio Morais, very successful in both companies, was giving his boldest step: the acquisition of a midsize business – in operation for 18 years – in the resale of vehicles, and which has as its corporate name *Driving* Comércio de Veículos Ltda. The business – given the expressive volume of resources involved – was developed for a long period of time. There were several analyses and projections undertaken, and also the steps of negotiations.

The economic scenario of the country was favorable: annual inflation amounting to more than 10%, retraction in most sectors, sell-off of industrial production, and the volatility of the financial market indicated the need for much caution in negotiations of this size. With regard to expectations, these too were not favorable. The troubled political scenario pointed that, this year, the economy would shrink around 4%, and the consumer confidence index was falling. There is, prudence in business would be fundamental to Antônio.

The negotiation was consolidated in March 31 2016, and Antônio's investment was basically coming from three sources: 70% of the amount resulting from the sale of Shoes to Guilherme Rodrigues (his second cousin), 15% of the amount was originally from financial reserves accumulated by the entrepreneur, and the remaining 15% from third-parties capital (medium-term loan with well-negotiated interest). Therefore, all that was left to do was to undertake well – once more – and make *Driving* a success!

## 3. THE *DRIVING* SITUATION AT THE TIME OF PURCHASE

The company, even though not presenting unsatisfactory results, needed be “rethought” right away. Antônio understood that there was potential to obtain even better results, and also room to further expand his new business.

The net revenue of the company – without the taxes levied on the revenue – over the past five years ranged from R\$7,925,000.00 and R\$14,050,000.00 and the total equity at the end of 2015 amounted to R\$12,499,000.00.

The team had 40 employees, distributed in three departments. The Department of Sales comprised the largest number (22 people); 15 were allocated in the administrative field (manager, assistant manager, and assistants), and the Department of Accounting had 3 other employees.

For understanding that a proper management of the property is important, as well as an efficient and effective control of the financial situation of the organization, the manager devoted special attention to information brought by the accounting area, with the aim of supporting possible and different forthcoming decisions.

The Accounting team of this company consisted of an accountant – responsible for preparing the Financial Statements – who worked in the company since its creation (18 years), and two assistants with over 8 years of work each.

The Financial Statements were subject of detailed analyses by the new manager. Individual meetings were held with the Department of Accounting for enlightening the information contained in such. Thus, the Balance Sheets for the last 5 years are presented on Chart 1.

<b>DRIVING COMÉRCIO DE VEÍCULOS LTDA</b>					
<b>BALANCE SHEETS FOR THE LAST 5 YEARS (In thousands of BRL)</b>					
	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>ASSET</b>	<b>12,499</b>	<b>12,402</b>	<b>11,803</b>	<b>11,800</b>	<b>9,166</b>
CURRENT ASSET	9,654	9,260	9,329	10,465	7,992
CASH ON HAND AND CASH ON HAND EQUIVALENTS	5,780	5,459	7,278	5,098	4,954
CUSTOMERS	2,644	2,785	975	4,321	2,355
OTHER CREDIT	586	568	417	432	309
INVENTORY	610	388	558	585	358
PREPAID EXPENSES	34	60	101	29	16
NONCURRENT ASSET	2,845	3,142	2,474	1,335	1,174
FIXED ASSET	4,050	4,021	3,287	2,071	1,719
OPERATING ASSETS	4,050	4,021	3,287	2,071	1,719
ACCUMULATED (-) DEPREC. AND AMORT.	(1.205)	(879)	(813)	(736)	(545)
ACCUMULATED DEPRECIATION	(1.205)	(879)	(813)	(736)	(545)
<b>LIABILITIES</b>	<b>12,499</b>	<b>12,402</b>	<b>11,803</b>	<b>11,800</b>	<b>9,166</b>
CURRENT LIABILITIES	1,578	1,612	1,275	1,477	647
LOANS AND FINANCING	-	2	13	23	39
SUPPLIERS	293	240	256	370	175
LABOR OBLIGATIONS	459	469	357	346	164
TAX OBLIGATIONS	821	896	642	730	265
OTHER OBLIGATIONS	5	5	7	8	4
<b>NET EQUITY</b>	<b>10,921</b>	<b>10,790</b>	<b>10,528</b>	<b>10,323</b>	<b>8,519</b>
CAPITAL INVESTED	5,000	5,000	5,000	400	400
INCOME RESERVE	5,921	5,790	5,528	9,923	8,119

**Chart 1:** Balance Sheets of the source company.

Source: Prepared by the authors.

Similarly, the Result Statements for the last 5 years are shown on Chart 2.

<b>DRIVING COMÉRCIO DE VEÍCULOS LTDA</b>					
<b>RESULT STATEMENTS FOR THE LAST 5 YEARS (In thousands of BRL)</b>					
	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
(=) NET OPERATING REVENUE	7,925	11,024	9,044	14,050	8,624
(-) COST OF MERCHANDISE SOLD	(5,096)	(6,893)	(5,599)	(7,741)	(5,136)
<b>(=) OPERATING INCOME</b>	<b>2,829</b>	<b>4,131</b>	<b>3,445</b>	<b>6,309</b>	<b>3,488</b>
(-) OPERATING REVENUE/EXPENSES	(3,083)	(3,854)	(3,337)	(3,908)	(3,015)
(-) COMMERCIAL EXPENSES	(1,356)	(1,795)	(1,495)	(1,755)	(1,306)
(-) ADMINISTRATIVE EXPENSES	(1,692)	(1,998)	(1,804)	(2,086)	(1,676)
(-) OTHER OPERATING EXPENSES	(43)	(76)	(57)	(93)	(35)
(+) OTHER OPERATING REVENUES	8	15	19	26	2
<b>(=) INCOME BEFORE THE FINANCIAL RESULTS</b>	<b>(254)</b>	<b>277</b>	<b>108</b>	<b>2,401</b>	<b>473</b>
(-) FINANCIAL EXPENSES	(93)	(46)	(19)	(23)	(13)
<b>(+) FINANCIAL REVENUE</b>	<b>527</b>	<b>505</b>	<b>597</b>	<b>678</b>	<b>307</b>
(=) INCOME BEFORE TAXES	180	736	686	3,056	767
<b>(-) INCOME TAXATION</b>	<b>(49)</b>	<b>(238)</b>	<b>(221)</b>	<b>(1,027)</b>	<b>(249)</b>
<b>(=) NET INCOME</b>	<b>131</b>	<b>498</b>	<b>465</b>	<b>2,029</b>	<b>518</b>

**Chart 2:** Result Statements of the source company.

Source: Prepared by the authors

Although equipped with Financial Statements and additional clarifications provided by the Accountant, Antônio Morais understood that – at this starting point of *Driving* management – hiring a Public Accounting would be wise, bringing a more refined vision about such Statements, and also free for having no bond or subordination with the audited company.

The idea, therefore, would be – merely – to increase the degree of confidence in the Financial Statements on the part of the user. It is noteworthy that the accounting information has always been important to Antônio Morais. Even in small-sized companies that he has previously administered, he has always sought in this information – whether by the Financial Statements, or by the possible analyses of them – support for his decisions.

Antônio has always been a student of accounting issues, in particular, fiscal and tax issues affecting his business directly. However, he understood that the whole set of information, which could serve him as a solid foundation for his management, must come from a professional in the field. To do so, even when he had no specific Department of Accounting in his companies – Shoes and Charme Dog –, he often consulted a third-party Accountant (who is also an auditor), in such a way this professional could “feed him” with the maximum information possible.

#### 4. PRELIMINARY REPORT

Antônio was aware that the auditor, when reviewing the Financial Statements, the internal control system, and the accounting system (or other systems), could properly communicate him about eventually detected deficiencies, and that – considering their relevance – they should be given his attention as a manager.

The auditor hired by Antônio Morais did all the work of planning and execution of the audit service and, before he could complete it, he could – based on the work done so far – send a preliminary report expressing his opinion about the Financial Statements, aiming at contributing to the orderly management of the company business. It should be noted that this is not yet the opinion of the auditor, but a document that anticipates possible “issues” in the Financial Statements, since Antônio is hurry to get these results.

In this specific situation, the entrepreneur receives the preliminary report of the auditor stating that the Financial Statements of *Driving* did not adequately present the equity and financial position of the company,

indicating – among other aspects – that the Financial Statements did not comprise the effects of the loss of purchasing power of the country’s currency (inflation), being such statements mistakenly prepared merely based on the Historical Cost and not, for instance, on the Adjusted Historical Cost. This would invariably cause distortions in the equity and financial situation.

In addition, it is noteworthy that other means and/or criteria for assessment and measurement of assets and liabilities should be observed, such as Adjustment to Present Value (regulated by the Norm NBC TG 12), Fair Mensuration Value (Norm NBC TG 46), Net Recoverable Value (Norm NBC TG 16), among others .

In this case, promptly, the lack of adjustment of assets due to inflation, the auditor included in the report a table released by the Central Bank of Brazil (BACEN) that contained information on the percentage of inflation accumulated in the last five years, which is measured by the Broad Consumer Price Index (IPCA) for being considered the official inflation indicator. The percentage is presented on Table 1.

**Table 1.** Percentage of accumulated inflation in the last 5 years

Years	Accumulated Percentage
2011	6.50%
2011 to 2012	12.71%
2011 to 2013	19.37%
2011 to 2014	27.02%
2011 to 2015	40.58%

Source: Central Bank of Brazil (2016)

Considering this context, Antônio Morais understood it was necessary to measure the impacts caused on Financial Statements due to such non-compliance, and to obtain the effectively correct information, also because some decisions could be based on accounting indices and the current composition of the company assets (without inflation adjustment) could distort their relevant interpretation.

## 5. ACCOUNTING IMPACT

After contacting the auditor and, aware of the whole situation, Antônio could not stop thinking about the Financial Statements. Taking into account that Brazil is a historically inflation country, we can easily perceive – albeit to a layman in economics or in accounting as Antônio – that despising the effects of inflation on the registered historical values would lead to information inconsistent with the actual value of these records in the present moment.

The loss of purchasing power of the currency – daily perceived in an inflation environment – would certainly not be properly reflected on the Financial Statements if disregarded the inflation adjustment of assets and liabilities.

Just imagine, for example, the registration of a good acquired five years ago – the historical cost – to be included in the balance sheet of the company with its original cost. Well, it is easy to assume that such original cost will not be properly reflected five years later, if it has not been adjusted. Furthermore, inflation adjustment entails exactly in the “maintenance” of the original costs over time.

Antônio remembered that, for a long time, he used to say things like: “the inflation adjustment is no longer permitted or required” or “the tax authority does not allow this procedure since 1996” and these considerations led him to believe that, in fact, the procedure should not be done. Such an honest mistake! A brief reading of the regulations would be enough – especially those issued by the Federal Accounting Council and which regulate the accounting profession – to verify that the practice is absolutely necessary.

Regardless of the inflation percentages considered (hopefully, obviously, at least the use of the official index released by the Federal Government), it is easy to envision how twisted the assets are without their adjustment over the years.

Faced with the information received from the auditor – on the non-compliance of the Statements – and aiming to verify (albeit partially) the impacts of the non-use of this procedure (inflation adjustment), Antônio Morais considers the possibility of contacting the Accountant who worked with him for many years in order to request the Balance Sheet and Result Statements of the company to be rewritten for the previous five year, thus being possible to promptly analyze the impact of non- adoption of the inflation adjustment of the Balance Sheet.

## 6. FINDING AND DECISION

Brazil is a country that has, historically, great volatility in the economy. And Antônio knows that! Born in 1968, during his youth he experienced moments such as the dictatorship, the Diretas Já movement, and hyperinflation. During the years 1985 and 1994, the country experienced a very delicate time, price markups, product shortages, impeachment, among many other problems. Specifically speaking of inflation, it would be enough to remember the year 1993, when the inflation exceeded the threshold of 2,000%!

Antônio was certainly aware that, currently, the economy is better, more solid, and with much lower rates of inflation. However, analyzing the 2014-2015-2016 period, for example, we could also perceive a resumption of inflation, and this would need to be considered for future analyses of accounting information.

Aware that the procedure that would properly ensure adjusted Financial Statements had not been accomplished, Antônio Morais understood that it was prudent (before making any decision) to question the Department of Accounting team (more specifically the Accountant) about the reasons to disregard such a relevant aspect for the proper representation of the equity.

He summoned the Accountant to a meeting that would be held in the current week. The summon made by the new manager left the Accountant worried. He – the Accountant – was aware that, as far as possible, he has been doing a good job. But he was also aware that in the previous administration he was hardly summoned, and when this happened, generally, they did not required of him anything but positions related to fiscal and tax issues that were arising, basically, from the extreme concern of the previous manager to pay less taxes.

He could not even remember a single occasion in which he had been called to participate in more “strategic” meetings of the company. At 9:00 a.m. of the meeting day, the manager and the Accountant (Mr. Jorge Farias) were face-to-face. Antônio Morais, aware of the motto “time is money,” objectively questioned:

*Mr. Jorge, I believe we won't go over any theoretical reference about economy so we can agree that we live in an inflation country, right? So, assuming that we couldn't agree more, could you please enlighten me why, throughout all these years, the Financial Statements of Driving were not under inflation adjustment?*

There was the problem! For the short time working with the new manager, Jorge knew his answer would possibly not convince him. But, anyway, there was nothing left but to tell him the truth:

*Mr. Antônio, over this period that I've been here – and note I'm talking about since the foundation of this company – I was oriented to concentrate all my efforts on fiscal and tax issues. Actually, I've always been requested exclusively on this aspect! My former boss used to work this way, you know? Well, you must also know that there is, since 1996, the ban – for tax effect – for adopting this practice. So... This is the reason that led us – with the consent and agreement on the part of the old manager – to not undertake the inflation adjustment.*

The discussion on these issues lasted about 40 minutes. Antônio left the meeting convinced of two things: that his management “style” was too different from the former owner of *Driving*; and that the Accounting team was not sufficiently proactive for, at least, proposing to the former manager the adoption of the correct procedure. Moreover, he was also convinced that it was possible to adjust the Financial Statements and to make the necessary tax adjustments.

Considering this context and the information received from the auditor – that no Statements had been prepared on the basis of correct accounting practices – the businessman, convinced that he would need to be provided with reliable information, finds himself facing two “dilemmas”: does he keep the current accounting team – considering that he is assuming the direction of the company at this moment – or does he replace the team with other(s) professional(s)? Would the possible difference in disregarded values influence the decision-making for the new company?



## 7. DATA SOURCE

This case study is fictional, therefore, data used for its creation were based on surveys conducted in theses, articles, books, and on the authors' knowledge about the addressed topics.

## 8. EDUCATIONAL OBJECTIVES AND RECOMMENDED USE

This case study aims to discuss the importance of inflation adjustment, and the impact on Financial Statements due to the non-adjustment of money amounts as well as its reflection on the equity of organizations and on business decision-making. Furthermore, the case seeks to provide a discussion on issues related to dismissal and hiring of employees.

The case was developed for use in Undergraduate Programs in Business and Accounting, in the subjects of Stock Accounting, Analysis of Financial Statements, and Financial Management.

## 9. LESSON PLAN

It is suggested that the professor asks the students to previously read the case and answer the proposed questions, before class. At the beginning of the class, the main concepts related to the topics covered in the case should be exposed to the students. After presenting the concepts, students will gather in small groups to discuss the proposed issues. Subsequently, resolutions of the questions should be exposed and debated in a larger group, and the professor must mediate discussions in the classroom. For the purposes of the case, we propose the following time distribution:

Activity	Duration (in minutes)
Brief exposition of concepts	25
Organization of the class in small groups (up to 4 students)	5
Discussion of the issues in groups	30
Discussion of the issues in a larger group	60
Closing of discussions and exposure of the theories presented in the case	25
<b>TOTAL</b>	<b>145</b>

**Chart 3:** Suggestion of time distribution for application of the Source Case  
Source: Prepared by the authors.

## 10. SUGGESTED QUESTIONS FOR DISCUSSION

1) Based on the information about the case, take the role of Antônio Morais' accountant and apply the inflation adjustment, based on the Broad Consumer Price Index (IPCA), for the Financial Statements for the 5 years presented.

2) Calculate the economic and financial indices of the Financial Statements with and without inflation adjustment for the 5 years presented and perform a comparative analysis. In addition, comment on which indices do not undergo changes with the impact of the inflation adjustment.

3) In your opinion, did the Accountant acted properly when disregarding inflation in the preparation of Financial Statements? Justify your answer.

4) The index used for the inflation adjustment of the Financial Statements was the IPCA, for being considered the official inflation index used by the Government. However, other indicators could have been used. Highlight another two options indicating what is the difference between them.

5) If you were Antônio Morais, before all the information shown, would you keep the current accounting team? Justify your answer.

## 11. CASE ANALYSIS

### 11.1 Inflation Adjustment of Financial Statements

The Inflation Adjustment of Financial Statements, unlike the Full Inflation Adjustment, will only levied on Fixed Assets (Investments, Fixed assets and Immaterial assets) and also on Net Equity. Rezende (2009) emphasizes that the Inflation Adjustment on these components of the Balance Sheet is justified, because these are the ones which remain longer coupled to the equity and, therefore, would be more outdated. The author also highlights that the difference of this adjustment (positive for Asset items and negative for Net Equity), should be recognized in the Result Statement in order to be able to know the profit or the loss of the company.

Previously, Oliveira, Marques and Canan (2007) had already mentioned that Inflation Adjustment seeks to eliminate distortions in the Financial Statements, considering the outdated of the Inflation Adjustment of the historical cost, the undervaluation of immaterial assets and Net Equity, concerning the current currency of the Financial Statements. The authors also mention that the technique consists of a method of recognition of inflation effects on Financial Statements, by applying a general price index in order to fix the values of Fixed Assets (Investments, Fixed assets and Immaterial assets) and of Net Equity. The counterpart of the adjustments should be placed in an account called "Inflation Adjustment," whose balance is transferred to the result as income or expense.

Since the Inflation Adjustment of Financial Statements occurs due to inflation, such can be measured in several ways. Thus, Vieira, Arruda and Tavares (2016) state that the inflation of each country is measured through indicators according to the change of prices of certain products, goods, or services; from this variation, we may calculate inflation, the rate by which prices increase in a given period of time. For our study, we used the Broad Consumer Price Index (IPCA), as suitable for measuring the effects of inflation.

Therefore, on Chart 4 we present the adjusted Balance Sheets.

<i>DRIVING COMÉRCIO DE VEÍCULOS LTDA</i>					
<b>ADJUSTED BALANCE SHEETS FOR THE LAST 5 YEARS (In thousands of BRL)</b>					
	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
<b>ASSET</b>	<b>13,653</b>	<b>13,250</b>	<b>12,283</b>	<b>11,969</b>	<b>9,242</b>
CURRENT ASSET	9,654	9,260	9,329	10,465	7,992
CASH ON HAND AND CASH ON HAND EQUIVALENTS	5,780	5,459	7,278	5,098	4,954
CUSTOMERS	2,644	2,785	975	4,321	2,355
OTHER CREDIT	586	568	417	432	309
INVENTORY	610	388	558	585	358
PREPAID EXPENSES	34	60	101	29	16
NONCURRENT ASSET	3,999	3,990	2,954	1,504	1,250
FIXED ASSET	5,693	5,107	3,924	2,334	1,830
OPERATING ASSETS	5,693	5,107	3,924	2,334	1,830



ACCUMULATED (-) DEPREC. AND AMORT.	(1,694)	(1,117)	(970)	(830)	(580)
ACCUMULATED DEPRECIATION	(1,694)	(1,117)	(970)	(830)	(580)
<b>LIABILITIES</b>	<b>13,653</b>	<b>13,250</b>	<b>12,283</b>	<b>11,969</b>	<b>9,242</b>
CURRENT LIABILITIES	1,578	1,612	1,275	1,477	647
LOANS AND FINANCING	-	2	13	23	39
SUPPLIERS	293	240	256	370	175
LABOR OBLIGATIONS	459	469	357	346	164
TAX OBLIGATIONS	821	896	642	730	265
OTHER OBLIGATIONS	5	5	7	8	4
<b>NET EQUITY</b>	<b>12,075</b>	<b>11,638</b>	<b>11,008</b>	<b>10,492</b>	<b>8,595</b>
CAPITAL INVESTED	7,029	6,351	5,969	451	426
INCOME RESERVE	5,046	5,287	5,039	10,041	8,169

**Chart 4:** Adjusted Balance Sheets

Source: Prepared by the authors.

In addition, on Chart 5 we highlight the Adjusted Result Statements.

<i>DRIVING COMÉRCIO DE VEÍCULOS LTDA</i>					
<b>ADJUSTED RESULT STATEMENTS FOR THE LAST 5 YEARS (In thousands of BRL)</b>					
	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
(=) NET OPERATING REVENUE	7,925	11,024	9,044	14,050	8,624
(-) COST OF MERCHANDISE SOLD	(5,096)	(6,893)	(5,599)	(7,741)	(5,136)
<b>(=) OPERATING INCOME</b>	<b>2,829</b>	<b>4,131</b>	<b>3,445</b>	<b>6,309</b>	<b>3,488</b>
(-) OPERATING REVENUE/EXPENSES	(3,083)	(3,854)	(3,337)	(3,908)	(3,015)
(-) COMMERCIAL EXPENSES	(1,356)	(1,795)	(1,495)	(1,755)	(1,306)
(-) ADMINISTRATIVE EXPENSES	(1,692)	(1,998)	(1,804)	(2,086)	(1,676)
(-) OTHER OPERATING EXPENSES	(43)	(76)	(57)	(93)	(35)
(+) OTHER OPERATING REVENUES	8	15	19	26	2
<b>(-) INFLATION ADJUSTMENT EXPENSES</b>	<b>(254)</b>	<b>277</b>	<b>108</b>	<b>2,401</b>	<b>473</b>
<b>(=) INCOME BEFORE THE FINANCIAL RESULTS</b>	<b>(93)</b>	<b>(46)</b>	<b>(19)</b>	<b>(23)</b>	<b>(13)</b>
(-) FINANCIAL EXPENSES	527	505	597	678	307
(+) FINANCIAL REVENUE	(1,211)	(507)	(418)	(665)	(477)
(=) INCOME BEFORE TAXES	(1,031)	229	268	2,391	290
<b>(-) INCOME TAXATION</b>	<b>(49)</b>	<b>(238)</b>	<b>(221)</b>	<b>(1,027)</b>	<b>(249)</b>
<b>(=) NET INCOME</b>	<b>(1,080)</b>	<b>(9)</b>	<b>47</b>	<b>1,364</b>	<b>41</b>

**Quadro 5:** Demonstrações de Resultado corrigidas

Fonte: Elaborado pelos autores

Given the Adjusted Financial Statements, we can perceive that the equity of the company in 2015 had an increase of 9.23% (from R\$12,499,000.00 to R\$13,653,000.00), representing an increase of R\$1,154,000.00 through inflation adjustment due to inflation. It is also noteworthy that as the Net Equity has higher values than the Fixed Assets, the difference arising from this adjustment resulted in an expense with the inflation adjustment, which levied directly on reducing the profit of the company, and since this expense is nondeductible for tax purposes, taxes on the profit remain the same.

## 11.2 Economic and financial Indices

Disregarding the inflation effect on the Financial Statements can greatly affect the result of the company. Thus, Ambrozini (2006) mentions that such fact is able to change the result determined in certain period, when compared with the adjusted Financial Statements. Therefore, there is the possibility of changing a number of important indicators widely used to analyze companies, among them, profitability of the Net Equity.

Oliveira, Marques and Canan (2007) add that inflation is not considered in Financial Statements, in addition to causing great losses in the quality of the information provided by the accounting, it can significantly change the result computed by the companies and, as a consequence, the distortion of the decision on the distribution of profits. Taking this into account, on Table 2 we present the calculation of financial and economic indices for Financial Statements with and without inflation, which were based on the study of Matarazzo (2010).

**Table 2.** Calculation of financial and economic indicators

Index	2011	2012	2013	2014	2015
Third-party capital sharing					
Without adjustment	7.59%	14.31%	12.11%	14.94%	14.45%
With adjustment	7.53%	14.08%	11.58%	13.85%	13.07%
Net equity immobilization					
Without adjustment	13.78%	12.93%	23.50%	29.12%	26.05%
With adjustment	14.54%	14.33%	26.84%	34.28%	33.12%
Noncurrent assets immobilization					
Without adjustment	13.78%	12.93%	23.50%	29.12%	26.05%
With adjustment	14.54%	14.33%	26.84%	34.28%	33.12%
Asset rotation					
Without adjustment	0.94	1.19	0.77	0.89	0.63
With adjustment	0.93	1.17	0.74	0.83	0.58
Net margin					
Without adjustment	6.01%	14.44%	5.14%	4.52%	1.65%
With adjustment	0.48%	9.71%	0.52%	-0.08%	-13.63%
Return on assets					
Without adjustment	5.65%	17.19%	3.94%	4.02%	1.05%
With adjustment	0.44%	11.40%	0.38%	-0.07%	-7.91%
Return on equity					
Without adjustment	6.09%	19.66%	4.42%	4.61%	1.20%
With adjustment	0.48%	13.00%	0.43%	-0.08%	-8.94%

Source: Prepared by the authors (2016).

When analyzing the capital structure indices (Participation of Creditors' Equity, Fixed Ratio, and Noncurrent Assets), which are classified as financial indices, in both cases they are considered good, because we perceive that the company shows no dependence on third parties and it also did not use third-party resources to finance Noncurrent Assets.

It is noteworthy that the Participation of Creditors' Equity index reduced in the adjusted statements, since whereas the Creditors' Equity remained constant, the Net Equity has increased. The indices of Fixed Ratio and Noncurrent Assets are the same, since the analyzed company does not have the Long-term Liabilities. On the other hand, the indices increased in the adjusted statements because Noncurrent Assets increased more than Net Equity.

Regarding the profitability indices (Ratio of net sales to assets, Net Margin, Return on assets, and Rate Earned on Net Equity), we observed that the Inflation Adjustment resulted in an expense, the same that directly levied on fall in profit. In the years of 2014 and 2015, this fall becomes even more evident, since the company goes from a surplus situation to a deficit situation. Therefore, this could reflect directly on a possible decision of distribution of profits.

The Asset was only fully used with net sales in 2012; thus, the company generates profit, and obtains returns with net equity, with the exception of the indexes of the adjusted statements of 2014 and 2015.

All profitability indices were reduced in the adjusted statements due to the fall in profits, driven by the expense with inflation adjustment. Concerning the viability of the business, even after the adjustment, it does not present a good return, since with the exception of the year of 2012, the company returns to its partners a percentage below 0.50% per year, which, if compared with the savings account (investment with low risk), there is a return of approximately 6% to 7% in the year.

It should be noted that the (financial) index of Indebtedness Composition and the indexes of liquidity (Liquidity Ratio, Current ratio, and Quick Ratio) have not undergone changes with the impact of inflation adjustment, since in their calculation formulas the Noncurrent Asset and the Net Equity are not included.

### **11.3 Legislation for making the inflation adjustment**

Inflation Adjustment was optionally introduced in 1944, by the Decree-Law no. 5,844, and became mandatory in 1964, by Law no. 4,357 (TAKAMATSU and LAMOUNIER, 2006). In addition, Ambrozini, Bonacim, and Assaf Neto (2008) emphasize that Law no. 6,404/1976 made Inflation Adjustment compulsory to Financial Statements for all Brazilian Publicly held companies. In 1977, with Decree-Law no. 1,598, the tax authority has determined, by the Income Tax Legislation, that all companies taxed by taxable income were also required to make the Inflation Adjustment of their Financial Statements.

In 1995, by Law no. 9,249, the Inflation Adjustment of Financial Statements was vacated, thus forbidding the use of any technique, including for corporate purposes (MONTEIRO and MARQUES, 2006). However, Ambrozini, Bonacim and Assaf Neto (2008) explain that since 1996, the publication of adjusted Financial Statements became optional. Whereas the Brazilian Securities Commission (CVM) warned companies under their supervision of the importance of preparation and disclosure of Financial Statements relevant to all accounting users. Hence, companies aiming to make the inflation adjustment should emphasize it in an explanatory note.

Highlighting the accounting legislation, the Federal Accounting Council (CFC), through Resolution no. 750/1993, established that one of the Accounting Principles to be applied in the accounting records was the "Inflation Adjustment," in which the effects of change in the purchasing power of the currency of the country should be recognized in the Financial Statements by adjusting the formal expression of the pecuniary components (CONSELHO FEDERAL DE CONTABILIDADE, 1993).

However, in 2001, CFC published the Resolution no. 900, explaining how the Principle of Inflation Adjustment should be implemented, emphasizing that the implementation of this principle would only be required if the inflation accumulated in the triennium exceeded 100% (CONSELHO FEDERAL DE CONTABILIDADE, 2001).

In 2010, Resolution no. 1,282 extinguished the Principle of Inflation Adjustment and vacated Resolution no. 900/2001. However, the same Resolution provided for, within another Principle (the Original Cost Record), the Inflation Adjustment, stating that the effects of changes in the purchasing power of the currency of the country should be recognized in Financial Statements by the adjustment of the formal expression of the values of the pecuniary components (CONSELHO FEDERAL DE CONTABILIDADE, 2010).

The aforementioned resolution (no. 1,282) was also vacated. It is noteworthy that the Norm NBC TG, which focuses on the Conceptual Framework for the preparation and presentation of Financial Statements (Resolution CFC no. 1,374/11), also indicates that one of the quality characteristics of financial accounting information involves precisely the need for its reliable representation.

For our case, we can adopt two strands to respond to the questioning. First, the student may be based on the premise that since 1996 the adjustment of Financial Statements has become optional, thus allowing us to choose it or not. On the other hand, the student can follow what the CVM and the NBC TG Conceptual Framework norm warn us about, stating that Financial Statements should represent relevant and reliable information, and inflation must not be disregarded.

#### 11.4 Inflation indicators

Regarding the inflation indicator, it is measured by several indices, published by various institutions (BACEN, 2016). As for the possibilities of adjustment indicators, on Chart 6 we present a summary of such. It is worth noting that there are also sectorial indices calculated by FGV (2017), although these are collected upon request and are not widely available.

Indicator	BACEN (2017)	IBGE (2017)	FGV (2017)	Summary of Indicators
INPC	X	X		National Consumer Price Index (INPC) – measures the variation in the cost of living of families with incomes between 1 and 5 minimum wages.
IPC	X	X	X	Consumer Price Index There are some variations in its calculation, but the logic is the same. Measuring the change in the cost of living of families with income between 1 and 40 wages. Variations: IPCA – Broad Consumer Price Index (official inflation indicator); IPCA-15 (completed on the 15th of every month); IPC-3I – Consumer Price Index for older adults; IPC-C1 – Consumer Price Index for 1st Level Consumers (with income between 1 and 2.5 minimum wages), IPC-S – Weekly; IPCFipe – São Paulo Consumer Price Index.
IGP	X		X	General Price Index (IGP) is the arithmetic average of the IPA, IPC, and INCC indices, respectively, Broad Producer Price Index, Consumer Price Index, and National Construction Cost Index. Commonly used as an index of contracts and money deflator.
IPA			X	Variations: IGP-DI – General Price Index – Domestic Availability (The data are collected between days 1 and 31 of the analyzed month); IGP-M – General Market Price Index (20 to 21); IGP-10 (11 to 10).
INCC			X	Wholesale Price Index – examines agricultural and industrial products.
				National Construction Cost Index.

**Chart 6:** Summary of General Price Indicators

Source: BACEN (2017); IBGE (2017); FGV (2017)

Based on the abovementioned indicators, we could also perform the adjustment with the indicators INPC and IGP.

## 11.5 Case resolution

It is noteworthy that this case study has no right or wrong answer; however, there are some decisions that must be made by the new owner of *Driving*, Antônio Morais.

Considering the discovery of mistakes committed by the Department of Accounting of the company in the preparation of the Financial Statements, Antônio is responsible for deciding whether he keeps the current accounting team or replaces it with new professionals. Antônio's decision must be based not only on the current situation of *Driving*, but also on the whole corporate history of those 18 years of existence of the organization.

To make this decision, we cannot disregard all knowledge that the responsible Accountant have about the company, since this employee works on it since its foundation. Perhaps, the Accountant will be the employee who will assist and advise Antônio in this beginning of the company management company, which is – until then – a new job for him.

The impact of the resignation of the Department of Accounting can negatively reflect not only on the company's operations due to adaptation, integration, and the lack of knowledge of the new team that will take on the sector, but also on the organizational environment, considering the insecurity that this attitude will bring to employees of other sectors of the organization.

A change of management usually distresses the employees of the company, according to Bertulucci (2006); changes bring about reactions, because novelties raise expectations, which may be positive and/or negative. The fact that you are not aware of upcoming events and decisions causes several feelings. In the case of *Driving*, the dismissal of an entire sector held by the new manager can make employees insecure and afraid of the new administration. Termination of employment by resignation is something meaningful in people's lives, since it is symbolically associated with personal failure, although some situations are not consequences of individual failure, yet they generate insecurity in individuals (CALDAS, 2000).

Another aspect to be analyzed by new managers comprise the decisions to be made from the new equity values presented to them. The equity reality that was demonstrated at the time of acquisition of *Driving* is not consistent with the reality depicted after accounting adjustments made. Therefore, Antônio must seek strategies along with his employees to make the company profitable.

On the other hand, Antônio must weigh in his decision that mistakes committed by the current accounting sector, considering the relationship of trust that must exist between the parties (Manager and Accounting Sector) in such a way that the company's performance is satisfactory. In addition, we should consider Antônio's perception regarding the lack of the team's proactivity in proposing to the former manager the adoption of the correct procedure regarding inflation adjustment of amounts recorded in equity. Furthermore, it is noteworthy that the fact that the company is under a new administration can change the performance of the sector as well as the entrepreneurial culture that is within the same.

Organizational culture comprises a dynamic character, which is revealed through expressions specific to each company, such as rules, norms, and routines that guide human behaviors and work as an element of communication and consensus (SCHADECK et al, 2016). Thus, Antônio should consider in his decision the possible change in the employees' behavior from the establishment of a new business management. It is important for him to evaluate the pros and cons when trying to change an entire culture established for more than 18 years; however, this changing process can be the best option for the new owner of the company, and a path to the success of *Driving*.

## USED AND RECOMMENDED BIBLIOGRAPHY

- AMBROZINI, M. A. **O impacto do fim da correção monetária no resultado das companhias brasileiras de capital aberto e na distribuição de dividendos: estudo empírico no período de 1996 a 2004.** 2006. 188f. Dissertação (Mestrado em Controladoria e Contabilidade) – Programa de Pós-Graduação em Controladoria e Contabilidade, Universidade de São Paulo, Ribeirão Preto, 2006.
- AMBROZINI, M. A.; BONACIM, C. A. G.; ASSAF NETO, A. O impacto do fim da correção monetária no resultado das companhias brasileiras de capital aberto e na distribuição de dividendos: Estudo Empírico no Período Pós-Plano Real. **Qualitas Revista Eletrônica**, v. 7, n. 2, 2008.

- BANCO CENTRAL DO BRASIL (BACEN). **Índices de Inflação**. 2016. Disponível em: <[http://www.bcb.gov.br/pre/portalCidadao/indecon/indice\\_inflacao.asp?idPai=PORTALBCB](http://www.bcb.gov.br/pre/portalCidadao/indecon/indice_inflacao.asp?idPai=PORTALBCB)>. Acesso em: 04 abr. 2016.
- BANCO CENTRAL DO BRASIL (BACEN). **Índices Econômicos Consolidados**. 2017. Disponível em: <<http://www.bcb.gov.br/pec/Indeco/Port/indeco.asp>>. Acesso em: 03 jan. 2017.
- BERTULUCCI, C. R. **Impactos emocionais causados pela mudança de estilo de gestão em um hospital na cidade de São Luis-MA**. 111f. Dissertação (Mestrado em Gestão Empresarial) – Escola Brasileira de Administração Pública de Empresas, Fundação Getúlio Vargas, Rio de Janeiro, 2006.
- CALDAS, M.P. **Demissão: Causas, efeitos e alternativas para empresa e indivíduo**. São Paulo: Atlas, 2000.
- CONSELHO FEDERAL DE CONTABILIDADE. Resolução CFC nº 750/93. **Dispõe sobre os Princípios Fundamentais de Contabilidade (PFC)**. Disponível em: <[www.cfc.org.br/sisweb/sre/docs/RES\\_750.doc](http://www.cfc.org.br/sisweb/sre/docs/RES_750.doc)>. Acesso em: 08 abr. 2016.
- CONSELHO FEDERAL DE CONTABILIDADE. Resolução CFC nº 900/01. **Dispõe sobre a aplicação do Princípio da Atualização Monetária**. Disponível em: <[www.cfc.org.br/sisweb/sre/docs/RES\\_900.doc](http://www.cfc.org.br/sisweb/sre/docs/RES_900.doc)>. Acesso em: 08 abr. 2016.
- CONSELHO FEDERAL DE CONTABILIDADE. Resolução CFC nº 1.282/10. **Atualiza e consolida dispositivos da Resolução CFC nº 750/93, que dispõe sobre os Princípios Fundamentais de Contabilidade**. Disponível em: <[www.cfc.org.br/sisweb/sre/docs/RES\\_1282.doc](http://www.cfc.org.br/sisweb/sre/docs/RES_1282.doc)>. Acesso em: 08 abr. 2016.
- CONSELHO FEDERAL DE CONTABILIDADE. Resolução CFC nº 1.374/11. **Dá nova redação à NBC TG Estrutura Conceitual – Estrutura Conceitual para Elaboração e Divulgação de Relatório Contábil-Financeiro**. Disponível em: <[www.cfc.org.br/sisweb/sre/docs/RES\\_1374.doc](http://www.cfc.org.br/sisweb/sre/docs/RES_1374.doc)>. Acesso em: 03 jan. 2017.
- FUNDAÇÃO GETÚLIO VARGAS (FGV). **Indicadores de Preços**. 2017. Disponível em: <<http://portalibre.fgv.br/main.jsp?lumChannelId=402880811D8E34B9011D92AF56810C57>>. Acesso em: 03 jan. 2017.
- INSTITUTO BRASILEIRO DE GEOGRAFIA E ESTATÍSTICA (IBGE). **Índices de Preços ao Consumidor**. 2017. Disponível em: <[http://www.ibge.gov.br/home/estatistica/indicadores/precos/inpc\\_ipca/defaulttab.shtm](http://www.ibge.gov.br/home/estatistica/indicadores/precos/inpc_ipca/defaulttab.shtm)>. Acesso em: 03 jan. 2017.
- MATARAZZO, D. C. **Análise Financeira de Balanços: Abordagem Gerencial**. 7 ed. São Paulo: Atlas, 2010.
- MONTEIRO, P. R. A.; MARQUES, J. A. V. C. Análise comparativa das demonstrações contábeis elaboradas pela legislação societária e em moeda constante: um estudo de caso. **Revista de Contabilidade do Mestrado em Ciências Contábeis da UERJ**, v. 11, n. 1, 2006.
- OLIVEIRA, A. T.; MARQUES, J. A. V. C.; CANAN, I. 11 anos sem correção! Uma análise dos efeitos da correção monetária não reconhecida nas Demonstrações Contábeis do Serviço Social da Indústria – SESI de 1996 a 2006. **Revista de Contabilidade do Mestrado em Ciências Contábeis da UERJ**, v. 12, n. 3, 2007.
- REZENDE, A. J. **Um estudo sobre o processo de desinstitucionalização das práticas contábeis de correção monetária em empresas brasileiras**. 2009. 267f. Tese (Doutorado em Ciências Contábeis) – Programa de Pós-Graduação em Ciências Contábeis, Universidade de São Paulo, São Paulo, 2009.
- SCHADECK, M. *et al.* Cultura organizacional e os sete pecados capitais: uma proposta para compreender os sistemas simbólicos. **Cadernos EBAPE.BR**, v. 14, n. 1, p. 164-181, 2016.
- TAKAMATSU, R. T.; LAMOUNIER, W. M. A importância da atualização monetária de valores para a análise das demonstrações financeiras. **Contabilidade Vista & Revista**, v. 17, n. 2, p. 67-87, 2006.
- VIEIRA, C. A. M.; ARRUDA, M. P.; TAVARES, A. L. O impacto da inflação no endividamento das instituições financeiras brasileiras. **Revista de Gestão, Finanças e Contabilidade**, v. 6, n. 1, p. 28-44, 2016.