



# The development of inflation accounting in Turkey

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## Abstract

Turkey, as a developing country, suffered from high inflation rates for many years. However inflation accounting was not applied till the year 2003 because of some political reasons. The high rates of inflation heavily distorted the financial statements of the companies in Turkey. The companies tried to benefit from the incentives in the Turkish Tax Regulation negating the effect of inflation till the year 2003. At the beginning of 2004 inflation accounting was applied at last. The purpose of this study is to emphasize the effects of inflation on the companies in Turkey and what they did in order to protect from the distortions of inflation till the year 2003. Also the regulations of the Ministry of Finance and Capital Market Board considering inflation adjustment were examined and compared by illustrations. © 2008 Elsevier Ltd. All rights reserved.

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## 1. Introduction

Turkey experienced high inflation rates from 1950s to 2000s; even this was regarded as an economic policy. The Governments<sup>1</sup> in Turkey postponed the economic stabilization program for reducing the inflation rates for years because the tax earnings of the State

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<sup>1</sup> Since 1970s, Turkey has been governed by 22 Governments.

will be reduced if the inflation rates decrease. Although the Governments tried to reduce the inflation rates by several disinflation attempts, they were not successful and efficient enough, therefore, the continuous high inflation rates<sup>2</sup> seemed like a confidential aim of the Governments.

High inflation rates in Turkey directed management policies of companies for years and made distortions on the financial statements of the companies. The incentives in the Tax regulations negating the effect of inflation on taxable profits were applied by companies till the year 2003. In the year 2003 inflation adjustment was applied to the financial statements of the companies that follow Turkish Capital Market Law.<sup>3</sup> For the other companies, Ministry of Finance made a regulation that requires inflation adjustment on the balance sheets of 2003. According to this regulation, balance sheets of the companies as at December 31st, 2003 are required to be adjusted for the past years, however the resultant profit of loss would not be taken into account for tax purposes. Ministry of Finance announced that if the conditions explained in the international accounting standards about hyperinflation<sup>4</sup> exist, in the following year's inflation adjusted income will be accepted as taxable income.

The year 2003 was a turning point for inflation accounting in Turkey. Inflation adjustments were made on financial statements, consequently understandable and comparable financial information was presented by these statements. Also the application of international accounting standards from the year 2003 as a part of convergence process in Turkey and abolishing the hyperinflation in Turkish economy through economic stabilization programs lead the financial statements of Turkish companies to become comparable with the financial statements of the foreign companies.

The aim of this study is to examine the history of inflation accounting and its applications in Turkey. The incentives in the Tax regulations negating the effect of inflation which were applied till the year 2003 and the inflation adjustments which were regulated by Ministry of Finance and Capital Market Board by the year 2003 explained and compared by illustrations.

We tried to emphasize the effects of inflation on accounting data in the framework of inflation–financial accounting relationship. High inflation rates effect the tax amounts paid by the tax payers<sup>5</sup> through increasing the term profits of the companies; hence we also focused on the inflation–tax accounting relationship.

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<sup>2</sup> The average of about 20% inflation rate in the 1970s, and 60% in the late 1980s and early 1990s, and finally, 80% in the late 1990s clearly show the persistence and the upward trend in inflation. The inflation rates in Turkey reached its peak of 120% in 1994 as stated later.

<sup>3</sup> The publicly traded companies and listed companies are subject to the Turkish Capital Market Law. Companies that have more than 250 shareholders are defined as listed companies.

<sup>4</sup> According to IAS 29 article 3, hyperinflation exists if the cumulative inflation rate over 3 years approaches, or, exceeds 100%.

<sup>5</sup> In the study we used the term “tax payers” just for companies. The individual tax payers are not in the scope of our study. The taxes paid by the individual tax payers might also be effected by the high inflation rates in Turkey, but our purpose is to emphasize the effect of inflation on the accounting data of the companies.

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