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THE EFFECTS OF GERMAN INFLATION ON ACCOUNTING RECORDS

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During the 1920's the German economy suffered through a terrible period of inflation. The rate of German inflation was so rapid that during the month of October 1923 only, the purchasing power of a paper mark fell from 1.0 on October 5th to 0.008 by October 31st. During the 1920's, Henry W. sweeney was attempting to develop a model for the U.S. which would handle accounting for changing prices. In preparation for the development of his model, Sweeney reviewed the German inflationary experience to determine the weaknesses of the German system.

Sweeney found several weaknesses in the German system and he detailed several difficulties that arose for accountants during that period. He also noted the undesirable effects that the breakdown had upon the Germans and German society.

Sweeney listed the weaknesses that he found in the German system as follows:

1. The book figures became dissimilar with respect to the equivalent value of the unit in which they were expressed. A monetary amount of one month could not be properly compared with an amount in another month because the valuation unit in which the amounts were expressed (the mark) was generally worth much less in the later month.

This first effect, he decided was probably the basic cause of all the succeeding ones in a period of monetary inflation.

2. Calculations of profit and loss became incorrect. Costs and expenses in marks could not be deducted from income expressed in marks if true profits or losses were to be ascertained. Hence, false profits appeared.
3. The real economic capital of the business was not maintained. Computation of depreciation on the basis of original cost per books was one main cause. The result was that the amounts reserved represented mere minor fractions of the purchasing powers of the amounts originally invested.
4. The accounting statements became inaccurate and misleading.
5. The net worth of each business entangled in the maelstrom of gyrating prices, false profits and feverish consumption of capital tended to show misleading increases.
6. Dividends tended to be paid from capital inasmuch as they were based, in most cases, on false book profits.
7. Income taxes likewise tended to be paid from capital.

A review of the list developed by Sweeney and a comparison of his list to recent comments heard about changing prices reveals that the problems and concerns of today are similar to those of yesterday.

SOURCE: Sweeney, Henry W., "effects of Inflation on German accounting," *The Journal of Accountancy*, February, 1928, pp. 180-91.