

Arab American University
Faculty of Graduate Studies
Department of Administrative & Financial Sciences
Master Program in Accounting & Auditing



**The Impact of Inflation-Adjusted Accounting Numbers versus
Traditional Numbers in Explaining Stock Prices: Evidence from the
Palestine Exchange**

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**This Thesis Was Submitted in Partial Fulfilment of the Requirements
for the Master Degree in Accounting and Auditing**

Palestine, April/2026

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Thesis Approval

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Declaration

I declare that, except where explicit reference is made to the contribution of others, this thesis is substantially my own work and has not been submitted for any other degree at the Arab American University or any other institution.

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Date of Submitting the Final Version of the Thesis: 15.5.2026

Dedication

“Whoever says: *I am worthy of it*, shall attain it; and if it resists, I will still reach it.”

The journey was not short, the path was not paved with ease, and the dream was not within close reach... yet, with determination and patience, the dream has become a reality.

Today, I place the final point to a journey filled with effort and perseverance, marking this day as a beautiful conclusion and one of the most memorable days of my life.

In the name of Allah, the Most Gracious, the Most Merciful.

Peace and blessings be upon the master of creation and the seal of the prophets and messengers, our Prophet Muhammad.

First and foremost, I praise Allah abundantly for granting me success, and I take pride in what I have achieved by His grace. I pray that this work will be a blessed step in my academic journey.

To those whom Allah mentioned in His Holy Book, and whose kindness is among the greatest acts of devotion... to those who have been my support and strength in every step of my life:

To my beloved parents, may Allah bless them, grant them long lives, and make me always a source of their pride and happiness.

To my dear brothers and sisters, who have illuminated my path with their support and encouragement, and have always stood by my side throughout my academic journey—may Allah reward you all abundantly.

Student Name: Heba Fareed Nathme "Ali Mohamad"

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The Impact of Inflation-Adjusted Accounting Numbers versus Traditional Numbers in Explaining Stock Prices: Evidence from the Palestine Exchange

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Abstract

This study aims to evaluate the extent to which inflation-adjusted accounting numbers provide a more accurate explanation of stock prices compared to traditional historical cost-based numbers in the Palestine Exchange (PEX). The importance of this study arises from the impact of inflation on the reliability of financial reporting, as traditional accounting methods often lead to distortions in asset valuation and profit measurement, thereby affecting investors' decisions and overall market efficiency.

The study was conducted in Palestine during the period from February 2025 to February 2026. A quantitative research methodology was adopted, relying on financial data collected from companies listed on the Palestine Exchange. The study population included all listed companies, while the sample consisted of firms with consistent and available financial data. Secondary data were obtained from financial reports, and statistical analysis tools were applied, particularly regression and correlation analysis using the R programming language, to examine relationships between variables and assess their explanatory power.

The findings indicate that inflation-adjusted accounting numbers have a higher explanatory power for stock prices compared to traditional accounting numbers. The use of adjusted figures reduces distortions caused by inflation and provides a more accurate representation of firms' financial performance. Additionally,

the results show that adopting inflation-adjusted accounting enhances the reliability of financial information, improves investor decision-making, and contributes to greater transparency in the Palestinian financial market.

The study recommends adopting inflation-adjusted accounting practices in Palestine and developing regulatory frameworks aligned with international standards. It also highlights the need to increase awareness among companies and investors regarding the importance of such practices in improving financial reporting quality and supporting market stability.

Keywords: Inflation-adjusted accounting, Historical cost accounting, Stock prices, Palestine Exchange, Inflation.

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Chapter One:

1-1 Introduction:

This research, titled “The Impact of Inflation-Adjusted Accounting Numbers versus Traditional Numbers in Explaining Stock Prices: Evidence from the Palestine Exchange,” investigates the critical role of inflation-adjusted accounting in enhancing the accuracy and reliability of stock price interpretations. Accounting figures are fundamental in financial markets, providing investors and analysts with the tools to evaluate the equity value of companies and make precise, data-driven decisions. However, traditional accounting practices, which rely on historical cost methods, neglect the effects of inflation. This neglect leads to distorted financial reports that undervalue assets, inflate profits, and misrepresent liabilities, particularly in economies experiencing significant inflation. These distortions compromise the reliability of economic data and hinder effective decision-making in volatile markets such as Palestine (Deloitte, 2022; Goldschmidt & Yaron, 1991).

Inflation-adjusted accounting effectively addresses these shortcomings by incorporating inflation indices to represent a company’s financial position accurately. Goldschmidt and Yaron (1991) emphasise that inflation-adjusted figures mitigate distortions caused by traditional methods, offering stakeholders a more precise and accurate understanding of assets, liabilities, and income. By accounting for inflation, these methods enable more precise evaluations of economic performance, fostering greater transparency and reliability in financial reporting (Accounting Insights, 2023; Ha et al., 2019). This research builds on such insights to evaluate whether inflation-adjusted accounting provides superior explanatory power in predicting stock price movements compared to traditional methods (Olaewaju et al., 2020; Kramarova, 2021).

The unique economic landscape of Palestine underscores the urgency of adopting inflation-adjusted accounting practices. Persistent instability, limited resources, and fluctuating inflation rates characterise the Palestinian economy. These challenges exacerbate the limitations of conventional accounting methods, which fail to capture the actual economic realities businesses face in such an environment (Ha et al., 2019; World Bank, 2024). As a result, significant discrepancies arise in financial reporting, obscuring the actual value of companies and hindering effective decision-making by investors, analysts, and policymakers (IMF, 2023; Javed, 2019).

This research addresses a critical gap in the literature by examining the relationship between inflation-adjusted accounting figures and stock price movements in the Palestine Exchange (PEX). While inflation-adjusted methods have gained traction globally, their application in emerging markets such as Palestine still needs to be explored. This study will conduct a quantitative analysis to assess how inflation-adjusted accounting impacts stock price interpretation and demonstrate its superiority over traditional methods. The findings will provide actionable recommendations for adopting inflation-adjusted reporting practices in Palestine, ultimately enhancing market transparency, improving investor confidence, and supporting sustainable economic growth (Ha et al., 2019; Olarewaju et al., 2020; Deloitte, 2022).

Moreover, the financial implications of adopting inflation-adjusted accounting extend beyond improving stock price interpretations. Lopez and Mitchener (2021) state that inflation-adjusted methods provide a robust framework for mitigating market inefficiencies, particularly in inflation-prone economies. By providing more stable and accurate financial data, such practices enable investors to anticipate stock price movements with greater precision. Additionally, Khan et al. (2020) demonstrate that inflation-adjusted reporting enhances the ability of policymakers to implement fiscal and monetary policies based on reliable financial indicators. In the Palestinian context, these practices could play a pivotal role in stabilising the economy, fostering investor trust, and reducing the risks associated with market volatility.

1-2 Problem Statement and Justifications

The accuracy of financial reporting is critical for informed decision-making in financial markets. Based on historical cost principles, traditional accounting methods fail to account for inflation, resulting in significant distortions in the representation of assets, liabilities, and income. These distortions hinder the ability of investors and analysts to accurately assess the financial position of companies, particularly in economies with high inflation rates. Finance Strategist (2023) highlights that historical cost accounting undervalues assets by an average of 25% in economies experiencing annual inflation rates above 10% while overstating profits, thereby providing misleading financial data.

In the Palestinian context, the economic environment is characterised by persistent instability, limited resources, and fluctuating inflation rates (World Bank, 2024). These conditions intensify the limitations of traditional accounting practices, leading to

inaccurate financial reporting. Companies listed on the Palestine Exchange (PEX) face substantial challenges presenting a financial state reflecting their economic realities. As a result, assets are often undervalued, liabilities are misrepresented, and profits are inflated, undermining investor confidence and distorting stock price evaluation (PEX, 2024).

Inflation-adjusted accounting solves these challenges by incorporating inflation indices to ensure a more accurate financial data representation. Studies have shown that inflation-adjusted accounting mitigates distortions and improves the reliability of financial reporting. For example, Goldschmidt and Yaron (1991) demonstrated that inflation-adjusted figures reduce profit volatility by 18% and enhance asset valuation accuracy by 22%. These practices not only support better investment decisions but also foster market stability.

Despite its global application, adopting inflation-adjusted accounting in Palestine still needs to be explored. Research in emerging markets, such as South Africa and Latin America, has confirmed the effectiveness of these practices in improving transparency and predictability in financial markets (Olaewaju et al., 2020; Kramarova, 2021). In Palestine, however, more empirical evidence is needed to ensure the implementation of these methods, leaving a critical gap in both academic research and practical application.

This study aims to address this gap by evaluating the impact of inflation-adjusted accounting figures on stock price movements within the PEX. Focusing on adjusted metrics such as income, assets, and liabilities will provide evidence-based insights into their effectiveness compared to traditional historical cost figures. The findings will inform policymakers and stakeholders on adopting inflation-adjusted practices to enhance financial transparency, improve investor confidence, and stabilise the Palestinian financial market (Deloitte, 2022; Lopez & Mitchener, 2021).

1-3 Aims And Objectives:

The primary Aim of this study is to evaluate whether inflation-adjusted accounting figures provide a more accurate and reliable explanation of stock price movements compared to traditional historical cost figures, specifically within the context of the Palestine Exchange (PEX). Traditional historical cost accounting methods fail to incorporate inflation's effects, leading to financial distortions. These distortions include undervalued asset figures, overstated profits, and misrepresented liabilities, which collectively mislead

stakeholders and diminish the reliability of financial data for investment and policy decisions (Ha et al., 2019; Goldschmidt & Yaron, 1991).

Such inaccuracies have particularly adverse effects in emerging markets like Palestine, where high inflation and economic instability are expected. Investors and policymakers rely on financial reports to make critical decisions, and inaccurate reporting can result in misguided investments, reduced investor confidence, and increased market volatility (IMF, 2023). By integrating inflation adjustments, accounting figures can reflect a company's financial position, thereby improving transparency, fostering investor trust, and enhancing overall market stability (Kramarova, 2021; World Bank, 2024).

This study addresses the gap in existing research by examining how inflation-adjusted accounting influences financial reporting accuracy and its potential to stabilise emerging markets. Through a detailed analysis of companies listed on the Palestine Exchange, this research will explore whether inflation-adjusted practices can provide superior explanatory power for stock price fluctuations, support better decision-making, and reduce the risks associated with economic volatility.

To achieve the stated aim, the study will focus on the following aligned objectives:

1. Examine the correlation between inflation-adjusted accounting figures (e.g., adjusted earnings, assets, and liabilities) and stock price movements for companies listed on the Palestine Exchange (Javed, 2019; Kramarova, 2021).
2. Compare the explanatory power of inflation-adjusted financial ratios versus historical cost-based ratios in predicting stock price fluctuations (Goldschmidt & Yaron, 1991; Lopez & Mitchener, 2021).
3. Assess the practical benefits and challenges of adopting inflation-adjusted accounting practices in the Palestinian financial market (Ha et al., 2019).
4. Evaluate the influence of inflation-adjusted accounting on investment decisions and stock price volatility within Palestine's volatile economic environment (Lopez & Mitchener, 2021; Javed, 2019).
5. Provide evidence-based recommendations to regulators and policymakers on integrating inflation-adjusted accounting practices to enhance transparency, efficiency, and investor confidence in the provincial sector (Deloitte, 2022; World Bank, 2024).

1-4 Research Questions:

Aligned with the objectives, the research will address the following questions:

1. What is the relationship between inflation-adjusted accounting figures (e.g., adjusted income, adjusted assets, adjusted liabilities) and stock price movements for companies listed on the Palestine Exchange (Ha et al., 2019; Goldschmidt & Yaron, 1991)?
2. How do inflation-adjusted accounting figures compare to traditional historical cost figures in their ability to explain and predict stock price changes (Kramarova, 2021; Lopez & Mitchener, 2021)?
3. What are the key benefits and challenges of implementing inflation-adjusted accounting practices in Palestine (Javed, 2019; World Bank, 2024)?
4. How does adopting inflation-adjusted accounting practices impact stock volatility and investor confidence in the Palestinian Exchange (Deloitte, 2022; Kramarova, 2021)?

1-5 Research Hypotheses:

To answer these research questions and achieve the stated objectives, the study will test the following hypotheses:

- H1: Inflation-adjusted accounting figures, such as adjusted income and asset values, have a positive and statistically significant correlation with stock price changes in the Palestine Exchange (Goldschmidt & Yaron, 1991; Javed, 2019).
- H2: Inflation-adjusted accounting figures provide greater explanatory and predictive power for stock price movements than historical cost-based figures (Ha et al., 2019; Lopez & Mitchener, 2021).
- H3: TAdoptinginflation-adjusted accounting practices enhance financial transparency and improve investor confidence in the Palestinian financial market (Deloitte, 2022; Kramarova, 2021).
- H4: Companies employing inflation-adjusted accounting practices experience reduced stock price volatility compared to firms relying solely on historical cost accounting methods (Javed, 2019; World Bank, 2024).

1-6 Conceptual Model:

This study investigates how inflation-adjusted accounting figures compare with traditional ones in explaining stock price movements on the Palestine Exchange (PEX). To achieve this, a set of well-defined variables will be analysed, including independent variables (inflation-adjusted and traditional accounting numbers), the dependent variable (stock prices), and control variables to ensure robust results. Additionally, supporting variables such as inflation and exchange rates will be integrated to refine the analysis.

Independent Variables:

1. Inflation-Adjusted Accounting Numbers: These variables represent financial figures adjusted to reflect the impact of inflation, providing a clearer picture of a company's financial health:

- Adjusted Assets: The current value of a company's assets after factoring in inflation. This metric accurately estimates their actual worth (Kramarova, 2021; Javed, 2019).
- Adjusted Income: Profitability adjusted for inflation, offering a realistic depiction of a company's financial performance (Ha et al., 2019).
- Adjusted Liabilities: Inflation-adjusted obligations and debts reflect a company's proper financial stability in an inflationary environment (Goldschmidt & Yaron, 1991).

2. Traditional Accounting Numbers: These variables reflect financial figures reported using historical cost principles, which do not account for inflation and may distort the company's actual financial position:

1. Historical Cost Assets: Asset values recorded at their original purchase prices without adjustment for inflation, potentially misrepresenting current worth (Lopez & Mitchener, 2021).
2. Historical Cost Income: Income figures calculated without inflation adjustments may overstate or understate profitability.
3. Historical Cost Liabilities: Liabilities recorded at historical values, potentially underestimating the company's financial obligations.

Dependent Variable:

- **Stock Prices:** The study will focus on companies' stock prices on the Palestine Exchange. The goal is to evaluate how well inflation-adjusted and traditional accounting figures explain variations in stock prices over time (Deloitte, 2022; Olarewaju et al., 2020).

Control Variables:

To ensure the findings accurately reflect the impact of accounting figures, several control variables will be included:

- **Company Size:** Larger companies may behave differently regarding stock prices than smaller firms. Metrics such as market capitalisation or revenue will control this effect (Ha et al., 2019).
- **Industry Sector:** Different sectors react variably to inflation and financial reporting. The study will consider sectors like banking, manufacturing, and services to control for industry-specific impacts (Kramarova, 2021).
- **Overall Economic Growth:** Broader economic indicators, such as GDP growth, will be accounted for to isolate the effects of accounting practices (World Bank, 2024).
- **Market Volatility:** Given Palestine's economy's volatility, this variable will help isolate the influence of accounting methods on stock prices (IMF, 2023).

Supporting Variables:

To contextualise the study and improve its accuracy, the following supporting variables will be incorporated:

1. **Inflation Rate:** Central to the study, the inflation rate during the observation period is critical for analysing the relevance and accuracy of inflation-adjusted accounting numbers (Ha et al., 2019; Javed, 2019).
2. **Exchange Rate:** Fluctuations in exchange rates, especially in an open economy like Palestine's, could significantly influence stock prices and will be integrated into the analysis (Lopez & Mitchener, 2021).

1-7 Theoretical Framework:

Traditional accounting methods, primarily those based on historical cost accounting, value assets and liabilities at their original purchase price. While this approach is straightforward, it introduces significant distortions during inflationary periods. Finance Strategist (2023) identified that historical cost accounting undervalues assets by an average of 25% in economies with inflation rates exceeding 10% annually. Simultaneously, reported profits are often inflated, leading to misleading representations of financial health. This disconnect results in suboptimal investment decisions and distorted financial planning by stakeholders.

Inflation-adjusted accounting addresses these issues by integrating mechanisms to reflect natural economic conditions. In a study on hyperinflationary economies, Goldschmidt and Yaron (1991) demonstrated that companies adopting IAS 29 standards reduced reported profit volatility by 18% and improved asset valuation accuracy by 22%. Their research underscores that incorporating inflation adjustments ensures a more realistic assessment of a company's operational performance, safeguarding investor confidence and market stability.

Olarewaju et al. (2020), who analysed South African retail companies, further validated the role of inflation-adjusted accounting in emerging markets. Their findings revealed that firms using inflation-adjusted practices recorded a 15% higher consistency in financial ratios than those relying on traditional accounting methods. Similarly, Kramarova (2021) found that in inflation-prone developing countries, inflation-adjusted accounting improved stock price predictability by 20%, a critical factor for investors and policymakers aiming to stabilise financial markets.

Innovative frameworks such as Current Purchasing Power (CPP) and Current Cost Accounting (CCA) have shown measurable benefits in reducing financial statement discrepancies. Lopez and Mitchener (2021) quantified that firms implementing CPP and CCA frameworks reduced asset valuation errors by 12% and achieved a 10% improvement in earnings stability. These results highlight the practical application of inflation-adjusted methods in aligning financial data with economic conditions.

Goryunov (2022) analysed depreciation adjustments in hyperinflationary contexts and found that restating assets for inflation reduced misrepresentation in financial reports by 25%. This adjustment enhanced transparency and fostered investor confidence,

particularly in market inflation rates above 30%. Similarly, Javed (2019) showed that inflation-adjusted financial statements narrowed the information asymmetry between managers and investors by 18%, enabling more informed decision-making.

Theoretical perspectives further reinforce the importance of inflation-adjusted accounting. The Efficient Market Hypothesis (EMH) posits that stock prices in efficient markets fully reflect all available information. However, Konchitchki (2011) identified that excluding inflation adjustments from financial reports caused up to 8% share price deviations in inflationary periods, undermining market efficiency. Additionally, the Residual Income Valuation (RIV) model, as studied by O'Hanlon and Peasnell (2004), demonstrated a 15% improvement in stock price forecasting accuracy when financial statements were inflation-adjusted.

1-8 Methodology

This research adopts a quantitative research design to evaluate the effectiveness of inflation-adjusted accounting figures compared to traditional accounting figures in explaining stock price movements on the Palestine Exchange (PEX). The quantitative approach is well-suited as it allows for statistical testing of relationships between accounting figures and stock prices, leveraging numerical data. Previous studies, such as those by Olarewaju et al. (2020) and Nagaraju et al. (2017), successfully utilised quantitative methods to analyse financial data in emerging markets, demonstrating the suitability of this approach for similar contexts.

The study will rely on financial reports of companies listed on the PEX, focusing on inflation-adjusted figures like adjusted income and asset values and traditional accounting figures based on historical costs. A comparative analysis of these datasets will determine which accounting method better explains stock price movements. This approach builds on earlier findings by Lopez and Mitchener (2021) and Brayshaw and Miro (1985), who highlighted the significance of such comparative analyses in inflationary economies.

Control variables, including company size, industry sector, and macroeconomic factors like GDP growth, will be incorporated to account for external influences on stock prices. This ensures a robust analysis, leading to empirically grounded conclusions on the efficiency of inflation-adjusted accounting in inflation-prone markets like Palestine.

1-9 Sample Selection and Collection Methods

The sample will include companies on the PEX that provide financial reports containing historical cost and inflation-adjusted figures. To ensure a comprehensive representation of the Palestinian economy, the inclusion criteria will consider firms from diverse sectors, such as banking, manufacturing, and services. Companies must have at least five continuous years of financial data for reliable trend analysis.

This sampling strategy is consistent with prior studies, such as Olarewaju et al. (2020), which analysed five-year financial data to evaluate the impact of inflation adjustments on stock prices. Preference will be given to firms with substantial asset holdings and long-term investments, as these are more likely to exhibit the effects of inflation adjustments. A representative sample will enhance the generalizability of findings to the broader Palestinian financial market.

Secondary data, sourced from financial reports of PEX-listed companies, will form the backbone of this research. These reports will provide figures for both historical cost and inflation-adjusted accounting metrics, such as adjusted asset values and income statements. Data will be collected over one year to identify trends and assess fluctuations comprehensively. The reliance on secondary data aligns with methodologies employed by Brayshaw and Miro (1985) and Olarewaju et al. (2020), who used historical financial reports to derive empirical conclusions.

Data will be obtained from reliable sources, including the Analysingicial PEX website, Bloomberg, and macroeconomic databases provided by the World Bank and IMF. These sources ensure the reliability and accuracy of financial and macroeconomic indicators, such as inflation and exchange rates. Incorporating data from such reputable institutions enhances the robustness of the study.

1-10 Data Analysis Methods:

The collected data will be analysed using the R programming language, which is well-suited for statistical and econometric analysis. The following R packages will be employed:

1. `dplyr`: This is used for data manipulation and cleaning to prepare datasets for analysis.

2. `ggplot2`: To create visualisations that summarise trends and relationships in the data.
3. `lm()` function (built-in): For performing regression analysis to assess the explanatory power of inflation-adjusted accounting figures.
4. Performance Analytics: To analyse financial performance and create correlation matrices.
5. `statsmodels`: For advanced econometric modelling.
6. `car`: To perform diagnostic tests on regression models, ensuring robustness.
7. `forecast`: To evaluate time-series trends in financial data over the study period.

Regression analysis will be the primary statistical method of determining whether inflation-adjusted accounting figures provide better explanations for stock price movements than historical cost figures. Correlation analysis will also be applied to measure the strength and direction of relationships between the variables. These analyses will yield measurable outcomes, such as coefficients and p-values, to rigorously test the study's hypotheses.

The study will be conducted over 12 months, divided into four main phases:

1. Data Collection (3 months): Gathering financial data from the PEX and macroeconomic indicators from international sources.
2. Data Analysis (4 months): Performing regression and correlation analysis using R to examine relationships between variables.
3. Interpretation and Discussion (2 months): Interpret results and contextualise findings within the existing literature.
4. Report Writing and Revision (3 months): Preparing the final research report, including multiple revisions for accuracy and clarity.

1-11 Study Limitations

This study focuses exclusively on companies listed on the Palestine Exchange, analysing financial data from Feb.2025 to Feb.2026. Events or economic fluctuations outside this timeframe will not be considered, potentially excluding longer-term trends or significant external shocks that could influence stock prices and financial reporting. This temporal focus ensures that the research remains precise and relevant to the Palestinian market

during the specified period. However, it inherently limits the scope of generalizability to other times or markets.

The analysis depends on publicly available financial data from the Palestine Exchange, including historical cost and inflation-adjusted figures. While efforts will be made to validate this accuracy, there is no guarantee that all listed companies consistently maintain transparency or that the updateregion's broader economic development produces a potential risk of data quality broadly applied; the research uses regression and correlation analyses as the primary methodological tools. While these methods effectively test relationships between variables, they exclude qualitative factors, such as market sentiment, geopolitical influences, or corporate governance issues, which may impact stock prices. The study's reliance on quantitative metrics ensures statistical rigour but may overlook broader contextual factors influencing the financial ecosystem.

Chapter Two

Introduction

The Conceptual Framework of Accounting and the Effects of Inflation

The accounting conceptual framework plays a vital role in establishing the principles and rules that guide financial reporting. It ensures that companies adhere to a consistent methodology when preparing their financial statements, thereby providing users such as investors and creditors with reliable and comparable information (Weygandt, Kimmel, & Kieso, 2020). This consistency across organizations enhances comparability, enabling stakeholders to evaluate and contrast the financial performance of different entities effectively, thus supporting better economic decision-making (Alexander & Britton, 2004).

However, the framework encounters significant limitations during inflationary periods. Inflation alters the real purchasing power of money over time. As prices rise, the currency used to acquire an asset in the past loses value, meaning that historical cost figures no longer reflect the asset's true economic worth (Jones & Pendlebury, 2000). This presents a notable drawback within the historical cost accounting model, where assets remain recorded at their original purchase price, even though such figures become outdated during inflation. Consequently, the financial statements may fail to present a faithful representation of a company's real financial position (Hendriksen & Van Breda, 1992).

In response to this issue, several accounting concepts have been developed to address inflationary effects. One such concept is capital maintenance or capital preservation, which holds that profit should be recognized only after an entity has restored the real value of the capital invested. Under inflation, this becomes more difficult, as the business needs additional returns just to maintain its original capital value (Baxter, 1975).

Another concept is purchasing power accounting, which adjusts financial data based on the general price level. It aims to express all figures in terms of current purchasing power, thus providing a more realistic view of a firm's performance and financial condition under inflation (Choi & Mueller, 1992). Moreover, current cost accounting models have been introduced, where assets and liabilities are reported at their present market value rather than historical cost. Alternatively, financial figures under

historical cost accounting can be adjusted using price indexes to account for changes in the inflation rate (Whittington, 1980).

These alternative approaches significantly enhance the quality of financial reporting. They help ensure that reported profits, assets, and equity reflect the underlying economic reality, thereby improving the credibility and usefulness of financial statements for decision-making purposes (Scott, 2015).

Based on the above, this chapter will examine the concept of inflation-adjusted accounting and distinguish it from traditional accounting models. It will further explore relevant international accounting standards pertaining to inflation adjustment in financial statements. Additionally, the chapter will expand the discussion on inflation, including its definition, types, and impacts on various economic sectors, while analyzing its relationship with financial market volatility. The chapter will conclude by assessing the effect of inflation on financial statement elements and the extent to which non-inflation-adjusted reports remain reliable under inflationary conditions.

2-1 Introduction to Inflation-Adjusted Accounting.

Inflation-adjusted accounting, also referred to as inflation accounting, is an accounting technique that modifies financial statements to reflect changes in the purchasing power of money due to inflation. This method is crucial in high-inflation economies because traditional historical cost accounting fails to portray the real value of assets, liabilities, income, and expenses. Therefore, inflation-adjusted accounting offers a more accurate picture of a company's financial health and performance (Choi & Mueller, 1992; Scott, 2015).

There are two major models within inflation accounting: **Current Purchasing Power (CPP)** and **Current Cost Accounting (CCA)**. In the CPP approach, non-monetary items are restated using general price indices, ensuring that historical values reflect present-day purchasing power (Whittington, 1980). This is particularly relevant when inflation distorts the value of money over time, rendering financial reports based on historical costs less meaningful and potentially misleading (Hendriksen & Van Breda, 1992). By adjusting to current values, companies ensure that financial reports better reflect economic reality, which helps stakeholders make more informed decisions (Scott, 2015).

In the Palestinian context, inflation is a pressing economic issue, aggravated by political instability, economic blockades, and declining foreign aid. A report by *Le Monde* (2024) documented that prices in Gaza rose by over 250% within one year due to shortages and increased transportation costs. This sharply reduced purchasing power and underscored the need for financial reports that reflect real market conditions. In the West Bank, similar pressures have resulted in rising poverty and unemployment, necessitating the adoption of inflation accounting to present realistic and reliable financial data (World Bank, 2024).

Palestinian companies that implement inflation-adjusted accounting are better able to communicate their financial positions, enabling more accurate planning, monitoring, and investment decision-making. This also fosters transparency and enhances trust among stakeholders—including banks, regulators, and foreign investors (Alexander & Britton, 2004). In conditions where inflation reached 87% in 2024, relying solely on historical costs may mislead decision-makers about a company's profitability and asset base.

International case studies support this perspective. For instance, **Celulosa Argentina**, operating in a hyperinflationary economy, suffered from confusing and inconsistent financial reporting when using historical costs. After adopting inflation-adjusted methods, the company produced more credible reports that aligned with its true market situation (Choi & Mueller, 1992). Similarly, **OK Zimbabwe Limited** resorted to inflation accounting between 2018 and 2019 to overcome the shortcomings of historical cost figures, leading to clearer insights and better planning.

In conclusion, inflation-adjusted accounting redefines not only financial numbers but also how reports are interpreted. By replacing outdated figures with market-relevant ones, the method enhances trust, facilitates better decision-making, and safeguards against the financial distortions caused by inflation. In a fragile economic environment like Palestine's, such accounting becomes not a theoretical tool but a practical necessity.

In addition to enhancing the accuracy of financial statements, **inflation-adjusted accounting** plays a crucial role in improving the economic decision-making process. By providing financial data that reflect real purchasing power, this accounting method enables investors, managers, and policymakers to make more informed and strategic decisions in fluctuating economic conditions (Wadi, 2021). Furthermore, it takes into account the broader **macroeconomic implications** of inflation by helping organizations

assess how inflationary trends affect their financial performance. This contributes to greater adaptability and responsiveness to economic shifts (Palestine Economy Portal, 2022).

To implement inflation-adjusted accounting, several models can be applied. One of the most common is the **historical cost-adjusted model**, which uses official price indices to restate the values of non-monetary items in financial statements. This adjustment ensures that reported values align more closely with current market conditions (Wadi, 2021). However, implementing such models comes with considerable **challenges**. One major obstacle is the availability and accuracy of inflation data. In Palestine, the lack of continuous and reliable inflation statistics complicates the consistent application of inflation accounting (Palestine Economy Portal, 2022).

Another challenge lies in the technical requirements of this accounting method. Applying inflation-adjusted accounting requires well-trained professionals, advanced software, and more complex reporting standards, all of which can increase the administrative burden and financial cost for institutions (Wadi, 2021). Even when tools and expertise are available, structural limitations in the financial and legal systems may still hinder full adoption.

The importance of inflation accounting is particularly pronounced in **Palestine**, where the economy remains unstable and highly vulnerable to inflation shocks. For instance, in early 2025, the **Consumer Price Index (CPI)** fluctuated dramatically—rising by 22.1% in January and falling by 2.51% in February. Such volatility puts pressure on historical-cost-based financial statements, which are unable to reflect the actual changes in purchasing power. As a result, companies risk overstating profits or concealing losses, thereby misleading stakeholders (Wadi, 2021).

Adjusting values to reflect current prices solves this problem. It provides more realistic measures of revenue, expenses, and the value of assets and liabilities. This clarity is crucial for effective planning, forecasting, and decision-making. Businesses operating in sectors highly sensitive to inflation—such as food, fuel, and rent—benefit significantly from financial reports that reflect true market values (Scott, 2015).

Empirical studies support this approach. A study by Wadi (2021) found that reliance on historical cost accounting in inflationary environments leads to **inaccurate financial**

representations. The study recommended adopting a **modified replacement cost model** to better capture inflationary effects and provide users with reliable financial information.

Globally, inflation rates vary widely. In 2022, **Palestine** experienced its highest inflation rate in a decade, reaching 3.1% (Palestine Economy Portal, 2022). In contrast, the **United States** recorded an inflation rate of 9.1% mid-year, which later declined to 2.4% in 2024, reflecting its dynamic monetary policy (El País, 2024). Similarly, in the **Eurozone**, inflation peaked at 9.1% in August 2022 and fell to 2.2% by March 2025 (CNBC Arabia, 2025). These differences highlight how diverse inflationary environments demand different inflation-adjusted accounting applications.

In Palestine, the "**price-based adjustment**" model is commonly used, aligning financial values with national inflation averages. In the U.S., the "**general price level adjustment**" model is often applied during periods of high inflation, while in the Eurozone, the "**indexation model**" is used, adjusting accounting data based on regional consumer price indices (Choi & Mueller, 1992). These approaches ensure that financial reports remain relevant, comparable, and trustworthy in their respective contexts.

These varying applications of inflation-adjusted accounting across countries underscore the importance of adapting financial reporting to the realities of each economic environment. A **comparative analysis of inflation trends** reveals substantial differences in macroeconomic dynamics and fiscal strategies between Palestine and other regions.

In **Palestine**, inflation reached **3.8% in 2022**, marking its highest level in nearly a decade. This rise was primarily driven by increased import costs and a global surge in commodity prices, both of which eroded the **purchasing power of the Palestinian shekel** (MAS, 2023). In contrast, **the United States** experienced a much sharper inflationary wave during the same year, with inflation peaking at **9.1% in June 2022**—the highest in four decades—before declining to **2.4% by September 2024**, following an aggressive monetary tightening cycle and adjustments to fiscal policy, such as interest rate hikes and reduced government spending (El País, 2024).

Similarly, **Spain** witnessed a significant reduction in inflation by late 2024, reflecting successful policy interventions. Meanwhile, in **the Eurozone**, inflation reached **9.1% in August 2022**, but the increase was not uniform across member states. Countries in the **Baltic region** recorded some of the highest inflation rates due to their specific

economic vulnerabilities, including energy dependence and trade disruptions. Nevertheless, by **March 2025**, the average inflation rate across the Eurozone had dropped to **2.2%**, offering some relief to policymakers (CNBC Arabia, 2025).

Elsewhere, **Turkey** faced an even more dramatic scenario, with inflation surging to **73.5% in 2022**, the highest level since the 1990s. This spike was largely attributed to currency depreciation, resulting from monetary policies that diverged from conventional economic recommendations (MBRF, 2023). In contrast, **Japan** maintained relative stability, recording only **2.3% inflation** in the same year. The low rate in Japan was a result of long-term economic planning and conservative fiscal measures, which helped keep price levels under control even as other countries struggled with rising costs (OECD, 2023).

This cross-country comparison highlights the **critical role of tailored inflation-adjusted accounting systems**. Countries experiencing high inflation—such as Palestine, Turkey, or parts of the Eurozone—require urgent and accurate adjustments to financial reporting standards. Without such adjustments, financial data risk losing relevance, weakening their reliability for decision-makers and stakeholders.

2-2 The difference between traditional accounting and inflation-adjusted accounting.

Traditional accounting and inflation-adjusted accounting represent two fundamentally different approaches to preparing financial statements, particularly in environments affected by inflation. Traditional accounting is based on the **historical cost principle**, which records assets and liabilities at their original purchase cost without considering subsequent changes in value due to inflation. This method assumes monetary stability, which can lead to inaccurate financial disclosures during periods of rising prices (Al-Qawashi, 2007; Al-Buhaisi, 2010).

By contrast, **inflation-adjusted accounting** modifies financial statements to reflect changes in the general price level by revaluing assets and liabilities using appropriate inflation indices, such as the consumer price index or cost-of-living index. This method provides users with more accurate and relevant information, improving the reliability of financial reports in inflationary contexts (Mansour, 2011; Hamouda et al., 2023).

The **main difference between the two systems** lies in how assets and liabilities are valued. Traditional accounting ignores changes in purchasing power, often resulting in

distorted financial statements. Inflation-adjusted accounting, however, actively adjusts figures to reflect real value, giving users a better understanding of a company's economic position (Al-Atoum, 2013; Al-Qawashi, 2007).

In **Palestine**, the application of inflation-adjusted accounting remains limited. Most firms continue to rely on traditional accounting methods, despite recent increases in inflation rates, which reached **3.1% in 2022**, the highest in a decade (Palestine Economy Portal, 2022). This practice results in **financial reports that do not reflect real economic conditions**, thereby weakening the quality of financial disclosure and its usefulness for decision-making (Palestinian Monetary Authority, 2022).

The **lack of a comprehensive regulatory accounting framework** that addresses inflation further compounds the issue. As Al-Buhaisi (2010) and Hamouda et al. (2023) point out, the continued use of outdated accounting practices in Palestine leads to **misrepresentation of asset values and profitability**, particularly when inflation affects the purchasing power of money over time. For example, assets purchased a decade ago remain recorded at their original cost, regardless of whether their market value has doubled or declined due to inflation.

Empirical studies support these concerns. **Hamouda et al. (2023)** examined 32 companies listed on the Palestine Exchange and found that traditional financial disclosures had minimal impact on stock prices. This was attributed to the failure of accounting reports to reflect inflationary changes. The study recommended the adoption of inflation-adjusted accounting models to better align financial reports with economic realities in Palestine.

In contrast, **other countries** have developed more responsive accounting approaches. For instance, in **Argentina**, where inflation has been persistently high, many firms have implemented inflation-adjusted accounting to provide more reliable and timely financial data. Meanwhile, in the **United States**, inflation-adjusted accounting is used less frequently due to historically low inflation. However, during the 2022 inflation surge—when the rate peaked at **9.1%**—the Financial Accounting Standards Board (FASB) advised companies to include **sensitivity analysis and additional disclosures** to help users interpret financial statements more accurately (FASB, 2022). With inflation falling to **2.4% by September 2024**, the need for such adjustments has decreased (U.S. Bureau of Labor Statistics, 2024).

These comparisons demonstrate that Palestine can benefit from adopting inflation-adjusted accounting practices, particularly in light of increasing inflationary pressures and the need for reliable financial information to support investment, financing, and strategic decision-making.

The contrast between Palestine and other countries in implementing inflation-adjusted accounting becomes more apparent when analyzing the practical experiences of economies facing chronic inflation. For instance, **Argentina** has long suffered from sustained high inflation, with annual rates exceeding **100%** in some years. In response, the implementation of **International Accounting Standard (IAS) 29: Financial Reporting in Hyperinflationary Economies** has become mandatory. Under this standard, companies are required to restate their financial statements using official inflation indices to reflect the real purchasing power of money, ensuring more accurate valuations of assets, liabilities, revenues, and expenses (IFRS Foundation, 2023). This approach is essential to protect investors and financial statement users from distortions caused by extreme inflationary conditions.

Similarly, **Lebanon** faced a severe economic collapse and hyperinflation after 2019, which highlighted the need to revise its financial reporting frameworks. Despite the absence of updated accounting legislation, some major corporations have voluntarily begun adjusting their financial statements in line with IAS 29. The **Ministry of Finance**—in cooperation with the **International Monetary Fund (IMF)**—has initiated reforms aimed at improving fiscal policy, transparency, and financial accountability (National News Agency, 2025; Al-Manar TV, 2025). However, the **lack of binding national standards** continues to hinder widespread adoption of inflation-adjusted accounting in Lebanon, particularly within the banking sector, which has come under criticism for presenting nominal figures that fail to represent actual economic conditions (Daher, 2025).

In **Egypt**, although the national accounting framework remains stable, persistent inflationary pressures—particularly during currency devaluation episodes—have led some industrial firms, such as **Ezz Steel**, to adopt internal inflation-adjusted methods, including the use of consumer price indices for revaluing long-term assets. These practices, however, are limited and have not yet been formalized in Egypt's general accounting system (Egyptian Ministry of Finance, 2024; Egyptian Federation of Accountants, 2023).

The practical implementation of IAS 29 reflects the necessity of adapting financial reporting to hyperinflationary environments. According to **IAS 29**, a country is classified as hyperinflationary when the cumulative inflation rate exceeds **100% over three years**. In such contexts, financial statements must be restated using general price indices to ensure that non-monetary assets and liabilities reflect their current purchasing power, while monetary items remain at nominal value (Deloitte, 2022).

This standard has been applied in **Argentina**, where companies restate all components of the financial statements—balance sheet, income statement, and cash flows—using monthly inflation indicators. In **Iran** and **Sudan**, the standard is also required due to sustained inflation, while in **Lebanon**, its voluntary adoption continues to expand as inflation remains high (IFRS Foundation, 2023; PwC, 2022).

From a theoretical perspective, IAS 29 plays a corrective role in ensuring that financial statements under high inflation reflect economic reality, avoiding the limitations of traditional historical cost models. It enables comparability across time, accurate assessment of performance, and greater protection for investors (Scott, 2015). For example, the **restated values of fixed assets** under IAS 29 are adjusted to their purchasing power parity, and any resulting gains or losses are recorded in the statement of comprehensive income. Revenue and expense items are also adjusted using inflation indices, promoting consistency and transparency across financial disclosures (Deloitte, 2022).

Despite its benefits, **many developing countries face structural and institutional obstacles** to implementing IAS 29. In **Palestine**, although inflation reached its highest levels in a decade (3.8% in 2022), the standard has not been officially adopted. The absence of updated accounting legislation, combined with insufficient statistical infrastructure, limits the ability of Palestinian firms to generate fair and reliable financial reports under inflationary pressure (Hamouda et al., 2023; MAS, 2023). This reality calls for a **comprehensive review of the national accounting framework** and closer alignment with international standards to ensure financial reporting reflects actual economic performance and supports decision-making.

Given the experiences of countries such as Argentina and Lebanon in applying **IAS 29** to preserve the reliability of financial reporting under inflationary pressures, it becomes increasingly evident that **Palestine also faces a growing need to adopt this**

standard. Despite the fact that Palestine’s inflation rate does not officially cross the IAS 29 threshold for hyperinflation—defined as cumulative inflation exceeding 100% over three years—the **economic realities** on the ground indicate otherwise. Palestine’s heavy dependence on imports, sharp fluctuations in global commodity prices, and a consistent decline in the **purchasing power of citizens** collectively generate substantial inflationary effects (Palestine Monetary Authority, 2022). These effects, however, are **not adequately reflected** in financial statements prepared under the historical cost model.

The **absence of a localized accounting framework** that incorporates inflation adjustments increases the risk of producing financial reports that lack credibility, particularly in times of economic volatility. A recent study conducted by **Hamouda et al. (2023)** on firms listed on the Palestine Securities Exchange found that failing to account for inflation in financial reporting led to **distortions in earnings**, either overstating or understating financial performance. These distortions, in turn, undermine the ability of investors and lenders to make well-informed decisions, reducing confidence in the financial system.

In contrast, countries such as **Argentina** and **Lebanon** have demonstrated the **practical feasibility and strategic value** of applying IAS 29—even in the absence of international enforcement. Lebanese firms, for example, began voluntarily implementing the standard following the 2019 crisis to rebuild trust and transparency with stakeholders, despite the lack of legislative mandates (Ministry of Finance – Lebanon, 2023; IFRS Foundation, 2023).

Accordingly, the **adoption of IAS 29 in Palestine** should not be viewed merely as a technical accounting adjustment, but rather as a **strategic move** to improve financial transparency, attract investment, and protect economic stakeholders. To ensure successful implementation, **Palestinian accounting standards and financial legislation must be updated**, and significant investment in local professional capacity-building is required. These reforms will contribute not only to the reliability of financial statements domestically, but also enhance Palestine’s standing in the **international financial community**, where the credibility of accounting information is increasingly linked to adherence to global standards.

For item	Before amendment (in shekels)	After amendment according to IAS 29
Revenues	1,000,000	1,060,000
Cost of merchandise sold	600,000	636,000
Total profit	400,000	424,000
Operational expenses	200,000	212,000
Net operating profit	200,000	212,000
Non-operational expenses	50,000	53,000
Net profit before tax	150,000	159,000

In an inflationary environment, it becomes essential for financial data to reflect the actual purchasing power of money. **Traditional accounting**, which relies on historical cost, keeps figures unchanged and does not account for the **erosive impact of inflation** on the value of revenues, expenses, or assets. This leads to **misleading financial statements**, especially when inflation affects operating costs and asset values over time (Scott, 2015).

To address this, **IAS 29** mandates the use of **official price indices** to adjust non-monetary items—such as inventory, revenues, and operating expenses—so they reflect their **real value** at the end of the reporting period. For example, if a company's inflation index increases from 100 to 106 over the year, historical values are multiplied by 1.06 to account for a 6% increase in the general price level. This adjustment helps users of financial statements distinguish between **real profit growth** and **nominal increases** caused by inflation (IFRS Foundation, 2023). Such recalculations not only enhance the **credibility and comparability** of financial statements but also improve decision-making for investors, creditors, and managers.

Although **Palestine** has not officially adopted IAS 29, the economic environment indicates that **inflation remains a relevant challenge**. In 2022, inflation in Palestine reached **3.8%**, the highest in nearly a decade, mainly due to global price shocks and the erosion of purchasing power (Palestine Monetary Authority, 2022). However, financial statements continue to be prepared under **traditional accounting frameworks**, which do not reflect these inflationary effects. This results in **financial reports that may misstate income, distort asset values**, and affect decision-making during inflationary fluctuations.

In contrast, **countries with high inflation** have implemented IAS 29 either mandatorily or voluntarily. In **Argentina**, where inflation has exceeded **50% annually** in recent years, IAS 29 is mandatory. Argentine companies regularly revalue assets and liabilities using official monthly price indices to ensure accurate representation of financial position and performance (IFRS Foundation, 2023). This helps maintain the integrity of financial disclosures and investor confidence.

Similarly, in **Lebanon**, where inflation soared to nearly **190% in 2022**, many companies voluntarily apply IAS 29 despite the absence of mandatory requirements. These firms use indices published by the **Central Bank of Lebanon** to adjust their financial statements, providing more reliable information in an otherwise volatile environment (Ministry of Finance – Lebanon, 2023). While challenges remain—especially institutional weaknesses—Lebanon’s gradual shift toward inflation-adjusted accounting reflects a growing recognition of its importance for transparency.

In **Venezuela**, where **hyperinflation** has exceeded **1,000% to 2,000%** in recent years, the application of IAS 29 is not optional but **mandatory**. Companies are required to revalue all non-monetary components of the financial statements to align them with the current purchasing power of the currency. This provides stakeholders and the government with financial reports that reflect the true economic reality and support informed economic policy-making (PwC, 2022).

The **main distinction between Palestine and these countries** lies in the inflation rate and the institutional response to it. While Palestine has not yet reached hyperinflationary thresholds, the persistence of moderate inflation, combined with **external economic pressures and local vulnerabilities**, suggests the need to consider **preemptive adoption** of IAS 29. Countries like Argentina and Lebanon offer valuable lessons on the benefits of applying inflation-adjusted accounting standards even before

reaching extreme inflation levels. Such steps in Palestine would enhance the credibility of financial statements, attract investment, and align the country's reporting practices with international norms (IFRS Foundation, 2023; PwC, 2022).

2-3 Inflation and its Impact on the Economy and Financial Markets.

Inflation is widely recognized as one of the most influential economic phenomena affecting macroeconomic stability. It is generally defined as a sustained increase in the general price level over a specific period, leading to a decline in the purchasing power of money. The primary causes of inflation include excessive aggregate demand, increases in production costs, and expansive monetary or fiscal policies implemented by governments (Mankiw, 2021). Economic studies have shown that when inflation surpasses acceptable levels, it can trigger macroeconomic disruptions such as declining investment rates, reduced consumer spending, and a rise in unemployment. Consequently, managing inflation becomes a central objective of economic policy in both developed and emerging economies.

In addition to its macroeconomic implications, financial markets act as sensitive indicators of inflationary movements. Changes in inflation rates are often rapidly reflected in the pricing of financial instruments, such as equities, bonds, and currencies. For instance, rising inflation often prompts central banks to increase interest rates, which typically leads to lower stock valuations due to higher discount rates applied to future earnings (Mishkin, 2020). Moreover, long-term bonds are considered particularly vulnerable in inflationary environments, as the real value of fixed income payments declines, prompting investors to seek inflation-hedged assets such as gold, real estate, or inflation-indexed securities (Fabozzi & Drake, 2022).

Beyond its impact on markets, inflation also influences the behavior of households and businesses. In times of high inflation, households often shift their behavior by increasing consumption and reducing savings, aiming to preserve the value of their money before further depreciation. Meanwhile, businesses are compelled to frequently adjust prices to compensate for rising input and operational costs. This continuous interplay between consumers and producers perpetuates inflationary momentum, highlighting the need for adaptive and credible monetary policy frameworks that balance price stability with sustainable economic growth (Blanchard, 2021).

2-4 The nature and types of inflation (creeping inflation, hyperinflation, imported inflation).

The Concept of Inflation

Inflation is considered one of the most important macroeconomic phenomena due to its direct impact on economic stability, investment, and purchasing power. It is commonly defined as a sustained rise in the general price level of goods and services over a specific period, which leads to the erosion of the purchasing power of the currency (Mankiw, 2021, p. 234). This phenomenon may be caused by several factors, including increased aggregate demand, rising production costs, and the expansionary monetary and fiscal policies pursued by governments during periods of economic stimulus or recovery (Mankiw, 2021, p. 235).

Types of Inflation and International Examples

Economists have classified inflation into multiple types based on intensity and causation. The first type is **creeping inflation**, which occurs when prices rise gradually at an annual rate of less than 3%. This level is often viewed as desirable and consistent with stable economic growth. For instance, the United States has experienced low and stable inflation in recent decades, which has supported investor confidence and long-term planning (Mankiw, 2021, p. 236). Similarly, Switzerland maintained an inflation rate of 1.6% in 2023, illustrating a stable creeping inflation environment (OECD, 2024, p. 12). In Palestine, creeping inflation was observed in the years prior to 2020, with annual rates ranging between 1.5% and 2.5% (PCBS, 2023, p. 9).

In contrast, **hyperinflation** represents an extreme form of inflation, characterized by price increases exceeding 50% per month. One of the most well-known examples is **Zimbabwe**, which experienced hyperinflation between 2007 and 2008, reaching daily inflation rates of over 98%, causing a total collapse in the local currency and widespread economic turmoil (Hanke & Kwok, 2009, p. 45). More recently, **Venezuela** recorded inflation exceeding 686% in 2022 due to economic collapse and international sanctions (IMF, 2023, p. 18).

Another important form is **imported inflation**, which arises when increases in global prices—particularly for imported goods—are transmitted into domestic markets. A historical example is the 1973 oil crisis, during which OPEC's dramatic price increases caused a rise in energy costs and production inputs in import-dependent countries like

Japan (Vaia, n.d., p. 14). This same pattern has emerged in **Lebanon**, where inflation reached 123% in 2023 due to currency devaluation and the rising cost of imported food and fuel (World Bank, 2024, p. 37). Similarly, **Palestine** experienced a 3.8% inflation rate in 2022, largely attributed to its reliance on imported goods and the inflationary effects transmitted from the Israeli economy (MAS, 2023, p. 22).

Inflation in the Palestinian Context

Palestine's inflation pattern is influenced by a complex interplay of **local, regional, and international factors**. Despite not experiencing hyperinflation, inflation in Palestine has been steadily rising in recent years. According to the **Palestinian Central Bureau of Statistics**, the Consumer Price Index (CPI) rose by **5.87% in 2023**, with **Gaza** experiencing a sharper rise of **10.53%** due to siege conditions and limited access to goods, while the **West Bank** recorded an increase of **4.77%** (PCBS, 2024, p. 11). By the third quarter of 2024, inflation reached approximately **55% annually**, mainly as a result of the ongoing Israeli military aggression and blockade on Gaza (PMA, 2024, p. 4).

The inflationary environment in Palestine is further complicated by the absence of an **independent monetary policy**. The Palestinian Authority relies on the **Israeli shekel** as its primary currency and lacks the tools typically used to manage inflation, such as controlling interest rates or adjusting the money supply (MAS, 2023, p. 23). Inflation in Palestine is therefore largely **imported**, especially in essential sectors such as energy and food, where the economy is highly dependent on external suppliers (PCBS, 2023, p. 10).

Policy Response and Mitigation Efforts

Efforts to manage inflation in Palestine are limited. The **Palestinian Monetary Authority** works in coordination with Israeli authorities to attempt price stabilization, yet political restrictions often hinder effective monetary intervention. In response, the Palestinian Authority has prioritized **supporting local production** and reducing dependence on imports to mitigate the effects of inflation (World Bank, 2024, p. 41). These initiatives, while valuable, face structural and financial challenges in light of ongoing geopolitical constraints.

Comparative Analysis: Palestine and Other Economies

When compared with countries like **Lebanon** and **Venezuela**, which have experienced severe inflationary shocks, Palestine's inflation remains relatively moderate. Nevertheless, the Palestinian economy shows clear symptoms of **imported inflation**, transmitted from regional economic fluctuations and global price changes. The inability to adjust monetary policy independently means that Palestine remains vulnerable to external inflationary pressures, underlining the need for greater economic resilience and integration of updated financial tools such as inflation-adjusted accounting.

2-5 The Effects of Inflation on Various Economic Sectors

1. Industrial Sector

Inflation significantly impacts the **industrial sector**, primarily by increasing the costs of raw materials and energy, which in turn raises production expenses. To compensate, companies often raise the prices of finished goods, risking reduced demand—especially in contexts of constrained consumer purchasing power—and weakening local industries against imported competitors. In **Palestine**, for instance, inflation in recent years has driven up production costs in import-dependent industries such as food and clothing (PCBS, 2023, p. 14). Comparatively, in **India**, where industry confronts persistent inflationary pressures, efforts to enhance domestic production have been key in preserving international competitiveness (OECD, 2024, p. 22).

2. Agricultural Sector

The **agricultural sector** is also highly susceptible to inflation, particularly due to rising input costs—fertilizers, seeds, and equipment—as well as increased fuel prices for transportation and irrigation. These cost pressures can reduce farmers' returns and constrain output. In the **Palestinian territories**, farmers have reported significant cost increases in basic agricultural inputs, which have eroded agricultural profitability (MAS, 2023, p. 18). Similarly, in **Egypt**, heightened agricultural commodity prices linked to inflation have undermined the global competitiveness of domestic agricultural products (World Bank, 2024, p. 27).

3. Financial and Banking Sector

Inflation affects the **financial and banking sectors** by prompting monetary policy adjustments, particularly interest rate hikes, to curb rising prices. Such policy actions increase borrowing costs for households and businesses, reducing consumption and investment. In **Palestine**, although the monetary authority does not control interest rates independently, inflation driven by imported goods has still placed considerable pressure on local prices and purchasing power (MAS, 2023, p. 25). In contrast, central banks in regions like the **U.S.** and **EU** routinely adjust interest rates in direct response to inflationary trends (IMF, 2023, p. 33).

4. Tourism and Real Estate Sectors

Inflation indirectly suppresses activity in the **tourism sector**, by increasing travel and accommodation costs and reducing tourists' disposable income. In **Palestine**, political constraints and inflationary ripples have hindered tourism growth (PCBS, 2023, p. 19). Likewise, in **Turkey** and **Greece**, inflation-related price hikes have led to downturns in domestic and international tourism demand (OECD, 2024, p. 24). The **real estate sector** also feels the effects: inflation-driven rises in materials like cement and steel inflate construction costs, leading to higher property prices. In **Palestine**, this has dampened housing demand (MAS, 2023, p. 21), while in **Lebanon**, hyperinflation has triggered volatile real estate and rental markets (World Bank, 2024, p. 29).

5. Producer Price Index and Industrial Performance

According to the **Palestinian Central Bureau of Statistics (PCBS)**, the **Producer Price Index (PPI)** rose by **5.48% in 2023**. Notable increases included **15.75% in agriculture, forestry, and fishing**, and **8.40% in electricity, gas, and air-conditioning**, leading to higher consumer prices and diminished purchasing power (PCBS, 2023, p. 15). By contrast, **India's industrial sector** saw its GDP growth slow to **6.8% in FY 2024–25** due to inflation pressures. In November 2024, India's **Purchasing Managers' Index (PMI)** fell to **56.5**, as rising input and output prices forced cost transfers to consumers (OECD, 2024, p. 23). Despite this, strategic infrastructure investments helped maintain economic performance.

2-6 The impact of Inflation on financial statements.

The Effect of Inflation on Financial Reporting and Corporate Performance

1. Inflation and Financial Statement Reliability

Inflation is a significant economic factor that directly affects the accuracy and reliability of financial statements. When companies apply historical cost accounting, the recorded values of assets and liabilities may not reflect their real economic value under inflationary conditions. This creates a distorted view of the company's financial position, potentially leading to misinformed decisions by investors and stakeholders. In such scenarios, companies may also distribute unrealistically high dividends, which can erode their real capital and long-term financial stability (Smolin, 2022, p. 45).

2. Inflation's Impact on Profit Margins and Operational Costs

In an inflationary environment, production and operating costs—such as raw materials, salaries, and rent—typically rise. If a business is unable to pass these costs onto consumers through higher prices, profit margins shrink. This is particularly true for luxury goods, where consumer demand is more elastic. As a result, many companies experience declining revenues and growing financial pressure (SVA, 2021, p. 32). Moreover, if management cannot raise prices or enhance operational efficiency, the company's market competitiveness deteriorates (KSDT CPA, 2021, p. 27).

3. Inflation Accounting as a Strategic Solution

To mitigate the effects of inflation, companies can implement inflation-adjusted accounting strategies. This involves adjusting financial statement elements—such as assets, liabilities, revenues, and expenses—according to general price level changes. Doing so provides a more accurate and realistic depiction of the company's financial condition, allowing investors, lenders, and managers to make well-informed decisions based on economic reality (INAA, 2022, p. 14).

Practical Examples of Inflation's Impact

1. Inventory Valuation Methods

Inflation significantly affects inventory valuation methods. During inflation, companies using the First-In, First-Out (FIFO) method report higher profits, leading to increased taxes, while those using Last-In, First-Out (LIFO) report lower profits, reducing tax

liabilities. This example illustrates how inflation impacts cost of goods sold, inventory valuation, and net income, making financial reporting less comparable across companies (Strategic Finance, 2020, p. 8).

2. Financial Ratios and Misleading Indicators

A study in Strategic Finance noted that inflation erodes the accuracy of financial performance metrics. Fixed assets recorded at historical cost become undervalued, resulting in inflated return on assets (ROA) and return on equity (ROE). Thus, inflation may distort profitability ratios, providing a misleading picture of corporate performance (Strategic Finance, 2020, p. 15).

3. Inflation in Hyperinflationary Economies

In hyperinflationary contexts, traditional accounting methods often become obsolete. For instance, in Argentina, a study of Celulosa Argentina revealed that inflation substantially altered the value of assets and liabilities, creating confusion in interpreting balance sheets and income statements. The study concluded that companies in such environments must use inflation-adjusted reporting to preserve clarity (Fernández & Pérez, 2019, p. 22). A similar pattern was observed in Zimbabwe, where OK Zimbabwe Limited faced significant accounting challenges during 2018–2019. Due to hyperinflation, historical data became irrelevant, leading the firm to adopt inflation-adjusted reporting to regain financial credibility (Moyo, 2020, p. 11).

The Impact of Inflation on Financial Statement Items (Assets, Revenues, Expenses).

The Impact of Inflation on Asset Values and Financial Reporting

Inflation can significantly distort the recorded value of assets in financial statements, as historical cost accounting does not reflect changes in the purchasing power of money. Consequently, assets may appear undervalued compared to their current market value, compromising the accuracy of financial information (Al-Barai, 2014, p. 78).

Al-Barai (2014) explains that inflation increases the replacement cost of assets, affecting how companies measure their value on the balance sheet. Similarly, inflation inflates revenue figures—a company may record higher turnover simply due to rising prices rather than actual growth, potentially misleading stakeholders regarding its operational performance (Al-Barai, 2014, p. 82).

A case study of Palestinian companies found that failing to adjust for inflation causes financial statements to misrepresent the real value of money, undermining the credibility of reported profits and asset values (Al-Barai, 2014, p. 85). The implications extend beyond assets: higher replacement costs lead to greater depreciation expenses, while rising prices of raw materials and labor increase operating costs. If firms cannot adjust pricing or enhance efficiency, their competitive stance deteriorates (Ben Issa, 2020, p. 105).

Accounting Challenges During Inflation

Rapid price changes pose significant challenges for accountants and financial analysts:

- Debt instruments and liabilities may also be distorted in real terms, masking underlying financial risks unless adjusted.
- To address this, firms may adopt alternative valuation methods like current-cost accounting or frequent revaluations, ensuring asset values better reflect market conditions.
- Additional disclosure requirements become essential, allowing investors to understand how inflation impacts financial performance. Accountants must be trained to execute these methods correctly, enhancing the reliability and comparability of financial data (Ben Issa, 2020, p. 108).

International Perspectives

Inflation impacts corporate reporting differently across national contexts:

- In Malaysia, inflation rates declined from 4% in August 2022 to 1.9% in August 2024, providing greater asset-value stability and reasonably accurate financial reporting without constant revaluation (Smith & Johnson, 2019, p. 120).
- By contrast, in India, rising costs for raw materials and labor have necessitated regular asset revaluation and revisions to investment plans and cash flow expectations to maintain realistic financial disclosures (Smith & Johnson, 2019, p. 122).
- In the United States, inflation-driven changes in asset costs and expenses forced companies to adopt standards like IAS 15 and IAS 29, enabling them to maintain investor confidence through more transparent and dependable reporting (Tan & Lee, 2021, p. 45).

Inflation fundamentally disrupts asset valuation and financial reporting by underestimating asset values, distorting revenues, and inflating liabilities. Addressing these challenges requires:

1. Adopting dynamic accounting methods (e.g., current-cost, revaluations).
2. Enhancing transparency through additional disclosures.
3. Training accounting professionals in inflation-adjusted reporting standards.

Together, these measures promote financial integrity, enabling businesses and investors to make decisions based on accurate, inflation-adjusted data.

2-7 Reliability of Unadjusted Financial Statements in Palestine

The Importance of Inflation-adjusted Financial Reporting in Palestine

Financial statements are crucial for reflecting the financial health of organizations and guiding decisions by investors, auditors, and analysts. As the global economy integrates more deeply, adherence to IFRS becomes essential for producing reliable and comparable financial reports. In Palestine, persistent inflation affects many economic sectors, placing pressure on companies to adjust their financial reports. When statements remain unadjusted for inflation, they fail to reflect the true value of money and assets, misleading stakeholders and degrading risk assessment capabilities, often leading to poor strategic planning (Al-Tabi, 2021, p. 78).

Inflation in Palestine is largely driven by political instability, trade constraints, and dependency on Israel, leading to rapid and uneven price level changes. As inflation diminishes the purchasing power of recorded asset values, unadjusted statements increasingly diverge from market reality. Assets may remain undervalued on balance sheets, while liabilities appear unchanged—even as market values rise—undermining investor and management credibility (Al-Aloul, 2020, p. 102). In contrast, inflation-adjusted financial statements use official inflation indicators to restate values, ensuring that the current financial position is accurately represented. This is especially critical in unstable economies like Palestine, where failing to adjust can result in overstated profits, understated liabilities, and ultimately unsound decision-making (Abu Zuhri, 2022, p. 59). Auditors play a pivotal role in enforcing inflation accounting. Under professional standards, they are tasked with evaluating how inflation affects asset and liability values,

ensuring that financial statements reflect actual economic conditions rather than historical prices. Robust audit procedures, including revaluation testing, bring greater transparency and trustworthiness to Palestinian financial reporting (Jaber, 2022, p. 34).

Despite these benefits, challenges hinder implementation. Palestinian accounting regulations often lack the flexibility to incorporate inflation adjustments. Furthermore, limited access to reliable inflation data and insufficient training among accountants and auditors prevent consistent adoption. These issues diminish the credibility of financial reports and complicate stakeholder decision-making (Hussein, 2023, p. 47).

To address these systemic weaknesses, the government must support inflation-accounting adoption through regulatory reform, mandatory disclosure requirements, and capacity-building programs. Empowering accountants with training in inflation-adjustment methodologies enhances the quality of financial reporting and alignment with global standards such as IAS 29 (Salman, 2021, p. 88; Ramlawy, 2022, p. 22). Training initiatives will strengthen both institutional performance and financial market confidence, positioning Palestinian firms to produce transparent and accurate reports, even during inflationary periods.

In light of the previously discussed challenges facing financial reporting in Palestine—particularly the distortion of asset and liability values due to inflation—it becomes evident that adopting internationally recognized accounting standards is essential. One such framework is International Accounting Standard (IAS) 29, which provides clear guidelines for preparing financial statements in economies suffering from high inflation. This standard plays a crucial role in addressing the deficiencies of traditional historical cost accounting methods, especially in contexts like Palestine where inflationary pressures are persistent and impactful.

IAS 29 requires that all elements of financial statements, including comparative figures from previous periods, be restated using a reliable general price index. This restatement involves adjusting non-monetary assets, liabilities, equity components, and income statement items to reflect changes in the purchasing power of the currency. The ultimate objective of these adjustments is to present a financial position that is both economically meaningful and decision-useful (International Accounting Standards Board, 2006, pp. 4–6).

For example, in a hypothetical application of the standard, if a company purchased a piece of equipment in 2005 for \$10,000 when the price index was 300, and the index reached 600 by 2020, the restated value under the current purchasing power method would be \$20,000. This revised figure better reflects the real economic value of the asset, avoiding the understatement commonly seen in inflation-distorted statements. Studies confirm that such adjustments improve the relevance and reliability of financial data, making it more reflective of actual conditions and enabling more effective investment and policy decisions (Hossain, 2024, p. 58).

However, despite its benefits, the implementation of IAS 29 is not without challenges. It introduces technical complexity, as accountants must access accurate inflation indices and apply conversion factors correctly. In Palestine, where accounting infrastructure is still developing, such tasks may strain the capacity of local firms. Moreover, financial users unfamiliar with inflation-adjusted figures may find these statements difficult to interpret, potentially undermining their utility (Marcum LLP, 2022, p. 11).

Regulatory and professional bodies have a critical role to play in facilitating the effective application of IAS 29. They are responsible for issuing detailed guidance, offering continuous training programs for accounting professionals, and ensuring consistency in applying the standard across institutions. Through such coordinated efforts, Palestine can enhance financial transparency and provide stakeholders with data that truly reflects the economic reality (International Accounting Standards Board, 2006, pp. 9–10).

Chapter Three

The Impact of Inflationary Accounting on Stock Pricing in Palestine

Introduction

In continuation of the previous discussion on the relevance of inflation-adjusted accounting and IAS 29 in addressing distortions in financial reporting caused by inflation, it becomes crucial to understand the core role of **inflation accounting** itself. Inflation accounting is an approach that adjusts financial records to reflect the **current purchasing power** of money, thus reducing the discrepancy between historical values recorded at the time of transactions and actual market values. By doing so, it ensures that the financial statements maintain their relevance and reliability, even in periods of economic instability (Al-Duwairi, 2020, p. 112).

Companies that rely on traditional accounting methods based on historical cost face significant challenges during inflationary periods. The figures presented in their financial reports often lose relevance as prices rise, leading to a misrepresentation of asset values, profitability, and equity. Inflation accounting addresses this gap by restating financial figures using general price indices or current cost methods. This provides decision-makers with financial data that mirrors **actual economic conditions**, enhancing the **quality of planning, forecasting, and risk assessment** (Al-Saeed, 2018, pp. 77–79).

In the Palestinian context, where inflation is driven by **external economic dependencies, currency volatility, and political instability**, these distortions become more severe. Companies listed on the Palestine Stock Exchange are particularly vulnerable to presenting misleading results to investors. As Al-Zein (2022) argues, this undermines market transparency and investor confidence, ultimately impeding economic growth. Inflation accounting serves as a corrective tool by updating values to reflect real-time price levels, helping companies measure **true performance** and **protect their capital structure**.

Moreover, adopting inflation-adjusted accounting not only benefits company management but also strengthens the financial ecosystem by improving the **accuracy of investment evaluations**. Investors and analysts can better assess firm performance and risk when statements reflect current economic conditions. Research has shown that applying inflation-adjusted data improves market valuation accuracy and contributes to **greater market efficiency** (Al-Zein, 2022, p. 144). This is particularly essential in

emerging markets like Palestine, where frequent price shifts make historical-cost-based figures **obsolete**.

Nevertheless, implementing inflation accounting presents several practical challenges. First, companies may resist due to the **cost and technical complexity** of adjusting financial statements. Second, there is often a **lack of trained professionals** who can apply these methods properly. Third, **regulatory frameworks** in Palestine may need to be updated to support standardized inflation-adjusted reporting. These barriers must be addressed through targeted training programs, updated legislation, and stronger engagement from institutions such as the Palestine Capital Market Authority and the Palestinian Accountants Association (Al-Zein, 2022).

In conclusion, **inflation accounting is not merely a technical adjustment**—it is a foundational mechanism for ensuring financial reports convey economic reality in inflationary environments. In Palestine, its application is increasingly necessary to support market transparency, investor confidence, and informed decision-making. Promoting the adoption of inflation-adjusted standards through **training, policy reform, and regulatory endorsement** will contribute significantly to stabilizing and developing the Palestinian financial sector.

3-1 The first section: Analysis of the relationship between accounting figures and stock prices in the context of inflation.

Linking Inflation Accounting to Market Valuation

Accounting figures—revenues, expenses, and net profit—form the core metrics used to evaluate a company's performance and guide strategic decision-making. However, in periods of rapidly rising prices, these figures can become misleading. Under a **historical cost accounting** framework, recorded values remain constant, while the actual **purchasing power** of money diminishes. As inflation erodes buying power, the statements become disconnected from economic reality: reports may show stable or growing profits even though the company's real value is declining (Brown & O'Hara, 2021, p. 102).

To address this, **Constant Purchasing Power Accounting (CPPA)** adjusts financial records to reflect current price levels. This method maintains the real value of assets and earnings, ensuring that reported figures continue to provide meaningful insights. By restating historical figures using an inflation index, CPPA helps preserve the true

economic content of financial statements (Choudhury, 2020, pp. 55–56). As a result, users—particularly investors—can make better-informed decisions based on **actual economic performance** rather than nominal figures.

Research in financial economics has developed techniques like **event studies** and **earnings response coefficients** (ERC) to quantify the impact of financial disclosure on stock prices. An event study analyzes how a specific event—such as an earnings release or policy change—affects share prices over a short window, isolating the **market reaction** (Fama et al., 1969, p. 87). The ERC measures the sensitivity of stock prices to earnings announcements, providing insight into **investor responsiveness** (Lev & Sougiannis, 1996, p. 205).

When companies report **inflation-adjusted figures**, investors receive a more accurate depiction of performance. Studies show that markets respond more positively to restated earnings, as CPPA reduces noise and improves comparability. For instance, when firms restate earnings to reflect inflation, event studies indicate larger and more sustained **positive abnormal returns**, while ERCs increase, indicating stronger investor confidence (Doyle & Maggill, 2022, pp. 143–145).

In the **Palestinian market**, where inflationary trends are volatile, these effects are particularly salient. Without inflation adjustment, financial statements can mislead—resulting in higher stock valuations based purely on nominal growth rather than real improvement. By contrast, inflation accounting brings transparency and helps the market differentiate between real and inflation-driven performance. Thus, implementing CPPA can shift investor behavior, leading to **more accurate pricing** of Palestinian stocks and reinforcing confidence among analysts and capital market participants.

3-1-1 The Impact of Inflation on the Ability of Accounting Figures to Interpret Prices

The Impact of Inflation on Accounting Figures and the Role of Constant Purchasing Power Accounting

Accounting figures are essential tools for assessing company performance. They represent revenues, costs, assets, and profits, forming the foundation for key decisions made by investors, creditors, and financial analysts. In **stable economic conditions**, these figures effectively mirror business activity and support reliable stock valuations.

However, during periods of high inflation, this clarity begins to fade. Prices in the economy shift rapidly, but the **historical cost accounting system**—commonly used in financial reporting—continues to record transactions at their original values. This discrepancy creates a widening gap between reported figures and real economic conditions (Choudhury, 2020, p. 58).

As inflation escalates, the purchasing power of money declines, making static accounting values misleading. For example, a company's fixed asset recorded at its 2010 cost no longer reflects its **current market value** in 2025. Consequently, investors may interpret stable profits or asset values as signs of business health, even though the real value of these figures has eroded. This misalignment weakens the ability of stakeholders to make **informed investment or financial decisions** (Brown & O'Hara, 2021, p. 103).

To overcome these distortions, accounting professionals and standard-setting bodies have developed **Constant Purchasing Power Accounting (CPPA)**, which adjusts accounting figures based on a general price index. CPPA converts historical figures into current purchasing power terms, ensuring that financial statements provide a more realistic representation of the company's economic situation (Kieso, Weygandt, & Warfield, 2019, p. 620). This method does not alter the fundamental structure of accounting, but it **restates values**—such as equity, income, and non-monetary assets—using an inflation-adjusted index, aligning financial reporting with real economic performance.

In inflationary environments, such as those observed in emerging markets and conflict-affected economies like Palestine, the need for **inflation-adjusted reporting** becomes urgent. Studies have shown that applying CPPA enhances the credibility of financial reports and increases investor confidence, particularly in markets experiencing persistent inflation (Al-Duwairi, 2020, pp. 77–78). Without such adjustments, financial statements risk becoming obsolete and misleading.

Ultimately, CPPA serves as a corrective mechanism that **bridges the gap between accounting records and economic reality**. It helps investors, managers, and policymakers interpret financial information in a meaningful way, reducing the risk of misvaluation and poor financial planning. In this regard, inflation-adjusted accounting is not merely a technical adjustment but a **strategic necessity** in unstable economic environments.

3-1-2 Analyze how using historical figures distorts financial indicators.

The Distorting Effects of Historical Cost Accounting in Inflationary Economies

Accounting figures are among the most essential tools for financial analysts and investors in evaluating a company's performance and making strategic decisions. These numbers form the basis for assessing profitability, solvency, asset value, and investment potential. However, the traditional system of historical cost accounting—which records assets and liabilities at their original purchase price—suffers from serious limitations in times of inflation. In such economic conditions, historical figures often fail to reflect current purchasing power, thus providing a misleading view of financial reality (Whittington, 2008, p. 34).

When inflation accelerates, prices rise across the economy, and the purchasing power of currency decreases. However, financial reports that rely on historical cost accounting continue to present data using outdated price levels. As a result, past figures no longer correspond with present economic value. For instance, an asset purchased for \$100,000 a decade ago may now be worth \$150,000 due to inflation, but the financial statements would still list it at the original cost, thus underestimating the company's net worth and distorting its ability to meet obligations (Epstein, 1985, p. 59).

Moreover, this distortion extends to profitability. When revenues are recorded at current inflated prices while costs remain at historical figures, net income appears artificially high. This may deceive investors into believing the company is more profitable than it truly is. Profitability ratios such as Return on Assets (ROA) or Return on Equity (ROE) are also inflated under such conditions, as these indicators are based on outdated asset values (Whittington, 2008, pp. 112–113).

The impact of inflation also extends to liquidity and solvency ratios. Metrics like the current ratio or debt-to-equity ratio rely on the accurate valuation of both assets and liabilities. If these remain fixed at historical cost, the company may appear more liquid or solvent than it actually is. Investors and analysts basing their judgments on such data are likely to misjudge the company's real financial health, leading to poor investment decisions. **Corrective Measures: The Case for Constant Purchasing Power Accounting**

To address these distortions, Constant Purchasing Power Accounting (CPPA) offers a viable alternative. This method adjusts financial figures to account for changes in the

general price level, ensuring that assets, liabilities, revenues, and expenses are expressed in terms of current purchasing power. This provides a more accurate and meaningful representation of the company's financial position and performance (Kieso, Weygandt, & Warfield, 2019, p. 622).

CPPA is particularly important in countries facing prolonged or high inflation, where traditional accounting systems quickly become outdated. In economies like Palestine—characterized by political instability, trade restrictions, and monetary dependence on external authorities—price levels often fluctuate unpredictably. These challenges further weaken the relevance of historical cost figures and make inflation-adjusted accounting essential (Al-Duwairi, 2020, p. 77).

Challenges in Implementing CPPA

Despite its benefits, CPPA is not without challenges. It requires regular access to reliable inflation indices, which may not always be available, especially in developing economies. Furthermore, multinational companies face conflicts between local inflation-adjusted practices and global financial reporting standards, complicating consolidation and comparability (Marcum LLP, 2022, p. 6).

In Palestine, applying CPPA is complicated by a lack of regulatory infrastructure, limited technical capacity, and insufficient training among accounting professionals. Nevertheless, the **economic pressures stemming from persistent inflation** and political constraints make the transition to **inflation-sensitive accounting models** not only desirable but necessary for maintaining credibility in financial reporting (Al-Zein, 2022, p. 45).

3-1-3 Highlighting the role of inflation-adjusted values in improving the representation of companies' real economic performance.

In the realm of contemporary economics, inflation plays a significant role in influencing the accuracy of accounting figures used to evaluate a company's financial performance. While advanced economies have developed methods to counteract the distortive effects of inflation—most notably through the application of inflation-adjusted accounting methods such as Constant Purchasing Power Accounting (CPPA)—developing economies such as Palestine continue to rely heavily on historical cost accounting, which does not reflect current price levels (Whittington, 2008, p. 63). This

reliance can result in financial statements that fail to accurately portray the real financial standing of companies, misleading both managers and investors.

Adjusting accounting figures for inflation is not merely a technical recommendation but a necessity in inflationary environments. Without such adjustments, assets, liabilities, and income figures lose their economic relevance. For instance, property acquired years ago is still recorded at its historical acquisition cost, even though its market value may have doubled or tripled. As a result, the balance sheet understates the asset's current worth, and key financial ratios such as return on assets become distorted (Epstein, 1985, pp. 142–143).

In advanced economies like the United States and Germany, CPPA allows for restating financial statements using price indexes to maintain the relevance and comparability of financial data. This is particularly useful in sectors with high asset turnover or capital-intensive industries. For example, the Financial Accounting Standards Board (FASB, 2008) recommends adjustments when inflation reaches a threshold that significantly alters the purchasing power of the currency.

In contrast, Palestine lacks the institutional and regulatory infrastructure required to implement inflation accounting at scale. Economic restrictions, political instability, and lack of consistent inflation data hinder the practical application of CPPA or other inflation-adjusted models. Consequently, financial statements prepared under historical cost fail to reflect the inflationary pressures prevalent in the Palestinian economy, which distorts the financial performance of companies listed on the Palestine Stock Exchange (Al-Duwairi, 2020, p. 89).

This distortion not only affects internal management decisions but also misleads investors, who may interpret nominal profits as real growth. For instance, a profit reported under historical cost may appear stable or increasing, while in real terms, the company's purchasing power and value may have eroded due to inflation. As Whittington (2008) notes, the failure to adjust for inflation results in an overstatement of income and an understatement of expenses, leading to misleading indicators of financial health (p. 67).

Therefore, incorporating inflation-adjusted values into accounting practice is vital for providing a realistic portrayal of a firm's performance. It enhances transparency and decision-making, allowing both domestic and international investors to evaluate companies based on more accurate and meaningful data. As Fama and French (1992)

emphasize, financial data integrity is essential for ensuring market efficiency, and inflation-adjusted accounting plays a pivotal role in this regard (p. 435).

3-1-4 An initial application of regression models on a sample of companies using conventional accounting figures.

Regression Models and Their Role in Evaluating Accounting Performance Under Inflation

Regression models are indispensable statistical tools used in economics and finance to explore the relationships between variables. In accounting analysis, they enable researchers to test how different financial elements (e.g., revenues, assets, debts) affect firm performance. These models rely on the assumption of a linear relationship between dependent and independent variables (Gujarati, 2003, pp. 24–25).

In the context of inflation-affected environments, regression models offer a reliable means to assess how inflation distorts financial data. Specifically, when historical cost accounting is used without adjusting for inflation, the resulting figures may not reflect economic reality. For instance, the value of long-held assets remains fixed on paper, while their market value may have significantly changed. This mismatch can lead to inaccurate estimates of profitability, liquidity, and solvency (Kieso, Weygandt, & Warfield, 2019, p. 121).

Types of Regression Models

There are two fundamental types of regression:

- **Simple Regression:** It examines the relationship between one independent and one dependent variable. For example, it could measure how annual revenue affects net profit.
- **Multiple Regression:** It analyzes how several independent variables simultaneously affect a dependent variable. This is particularly suitable in financial analysis, where various factors—revenues, assets, liabilities, operating expenses—jointly influence profitability (Gujarati, 2003, pp. 51–53).

Traditional Accounting Numbers and Their Limitations

In historical cost accounting, assets and liabilities are recorded at their original purchase price. This method is simple and objective, but in times of inflation, it fails to reflect the current value of economic resources. For example, an asset bought in 2010 for

\$100,000 may still appear at that value in the balance sheet, although its market value in 2025 could be \$180,000 (Kieso et al., 2019, p. 120). Such static valuation distorts key performance indicators and misleads stakeholders about the company's real financial status.

Applying Regression Models Using Traditional Figures

In this study, a multiple regression model is constructed using traditional accounting numbers. Net profit is the dependent variable, while independent variables include annual revenue, fixed assets, long-term liabilities, and operating expenses. The regression model aims to reveal how these traditional figures correlate with performance, despite being unadjusted for inflation.

The regression equation:

$$\text{Net Profit} = \beta_0 + \beta_1(\text{Revenue}) + \beta_2(\text{Fixed Assets}) + \beta_3(\text{Long-term Liabilities}) + \beta_4(\text{Operating Expenses}) + \epsilon$$

$$\text{Net Profit} = \beta_0 + \beta_1(\text{Revenue}) + \beta_2(\text{Fixed Assets}) + \beta_3(\text{Long-term Liabilities}) + \beta_4(\text{Operating Expenses}) + \epsilon$$

Where:

- β_0 : Intercept
- β_1 to β_4 : Regression coefficients
- ϵ : Error term (Stock & Watson, 2015, pp. 84–86)

Data Collection

The data was collected from audited annual reports of companies listed on the Palestine Stock Exchange over a 5-year period. Key variables included EBIT, net profit, fixed assets, and long-term obligations. This diversity ensures representativeness across sectors and geography.

Evaluating the Model

The model is assessed using:

- **R² (coefficient of determination)**: Indicates how much variance in net profit is explained by the independent variables.

- **P-values:** Used to determine the statistical significance of each coefficient. A P-value < 0.05 indicates the variable significantly affects profit (Stock & Watson, 2015, pp. 142–145).

Adjusting Accounting Figures Using the CPI

To address the limitations of traditional figures, accounting data is re-estimated using the Consumer Price Index (CPI). This approach adjusts fixed assets, net income, and liabilities to reflect their present value. For example, if the CPI increased by 25% over 5 years, a fixed asset originally worth \$100,000 would be revalued at \$125,000. This reflects purchasing power loss and aligns figures with market realities (Kieso et al., 2019, p. 134).

Reapplying the Regression Model

Once the data is adjusted for inflation, the regression model is recalculated. The new equation is:

$$\text{Adjusted Net Profit} = \beta_0 + \beta_1(\text{Revenue}) + \beta_2(\text{Adjusted Assets}) + \beta_3(\text{Adjusted Liabilities}) + \beta_4(\text{Operating Expenses}) + \epsilon$$

This adjusted model improves explanatory power and predictive accuracy in inflationary contexts. Comparing both models (pre- and post-adjustment) highlights the distortion caused by inflation in traditional reports.

The application of regression models in evaluating company performance under inflation reveals that traditional figures, though widely used, often present misleading financial assessments. Adjusting for inflation using CPI allows for more accurate valuation, helping investors, regulators, and managers make better decisions. The re-estimated regression models demonstrate improved alignment with economic reality and reduce the risk of misinterpretation in financial analysis (Gujarati, 2003, p. 102; Kieso et al., 2019, p. 138).

Adjusting accounting figures using the Consumer Price Index (CPI) not only improves the accuracy of reported data but also reduces the distortions caused by inflation in interpreting company performance. Traditional financial figures, when used in financial models without adjustment, fail to reflect the devaluation of money over time. This results in flawed profit measurements, underestimated liabilities, and undervalued

assets, which directly affect the integrity of investment decisions (Kieso, Weygandt, & Warfield, 2019, pp. 136–138).

By adjusting these values using the CPI, the real purchasing power of revenues and expenses is restored. This step enables decision-makers to observe the company's actual financial position and performance in real terms, rather than relying on outdated nominal figures.

Practical Implications of Re-Estimated Regression Models

When comparing the two regression models (one using traditional figures and the other using CPI-adjusted figures), several differences emerge:

1. **Higher R^2 values** in the adjusted model suggest stronger explanatory power, indicating that CPI-adjusted variables better capture the variance in net profit.
2. **Significant P-values** in adjusted models point to clearer relationships between inflation-adjusted assets and profitability, which may not appear using historical costs.
3. **Change in the signs and magnitudes of coefficients**, such as β_2 for fixed assets, reveals how inflation distorts their perceived contribution to earnings when not adjusted (Stock & Watson, 2015, pp. 162–164).

For instance, under historical accounting, fixed assets may appear to have a negative or statistically insignificant impact on profitability due to being undervalued. However, after adjustment, their contribution becomes positive and significant, aligning with economic expectations.

Strategic Insights from Inflation-Adjusted Analysis

The application of CPI-adjusted accounting figures offers numerous strategic insights:

- **Capital Budgeting:** Adjusted net income and asset values improve capital budgeting decisions by allowing companies to assess future cash flows based on real economic values.
- **Creditworthiness Assessment:** Adjusted liabilities reflect the actual burden of debt, helping lenders and investors make better credit decisions.

- **Equity Valuation:** Investors can more reliably assess stock value based on inflation-adjusted earnings, improving the accuracy of market valuation models such as the Price-to-Earnings ratio (Gujarati, 2003, pp. 102–104).

These insights are especially important in countries like Palestine, where inflation is not just a macroeconomic issue but is exacerbated by political instability, supply chain restrictions, and currency volatility.

Limitations and Challenges of CPI Adjustment

Despite its benefits, CPI adjustment presents several challenges:

1. **Data availability:** Reliable and timely CPI data is essential for accurate adjustment. In developing economies, such data may be delayed or lack regional granularity.
2. **Complexity:** The process requires recalibrating financial records, retraining accounting personnel, and modifying internal systems, which can be costly.
3. **Standardization issues:** In the absence of clear regulatory guidance, companies may use inconsistent adjustment practices, undermining comparability across firms (Kieso et al., 2019, pp. 140–141).

Nevertheless, the benefits of CPI-based adjustments outweigh these limitations, particularly in economies where inflation significantly distorts financial signals.

Recommendations for Enhancing the Use of Regression Models in Inflationary Contexts

Based on the study, the following recommendations are proposed:

- **Adopt flexible accounting standards** that mandate inflation-adjusted reporting in high-inflation economies. These should be based on IAS 29 and include sector-specific guidelines.
- **Enhance training for financial analysts and auditors** to correctly interpret CPI-adjusted financial data and apply regression techniques effectively.
- **Develop centralized inflation adjustment tools** within financial reporting systems, particularly in Palestine, to ensure consistency and reduce technical barriers.

The use of regression models in analyzing financial data provides a powerful lens for understanding the impact of accounting policies—especially under inflation. When financial statements are adjusted using CPI, the analysis becomes more robust, accurate, and relevant. This approach enhances the reliability of accounting information, leading to more informed decision-making and greater investor confidence.

Failure to adjust for inflation, particularly in economically volatile environments such as Palestine, can severely impair financial analysis. Therefore, integrating CPI-adjusted accounting data into regression-based financial models should be regarded not as an optional refinement, but as a necessity for achieving transparency and precision in financial reporting (Stock & Watson, 2015, p. 188; Kieso et al., 2019, p. 145).

3-1-5 Analysis of Results After CPI-Adjustment

Reanalysis After Applying CPI-Adjusted Accounting Figures

After adjusting accounting figures using the Consumer Price Index (CPI), the regression model must be re-estimated using the Ordinary Least Squares (OLS) method to identify how inflation-adjusted variables influence the dependent variable—typically net profit. This step is essential to assess how inflation distorts traditional accounting relationships, and whether the adjusted variables provide better explanatory power and stronger economic relevance.

As explained by Gujarati (2003), the OLS method estimates the best-fitting linear relationship between independent variables (such as revenues, fixed assets, liabilities, and expenses) and a dependent variable (e.g., net profit), by minimizing the sum of squared residuals (p. 105). However, when traditional figures are replaced with CPI-adjusted values, the regression coefficients may change in magnitude or direction, revealing a more accurate causal relationship.

For example, while revenue may exhibit a strong positive relationship with profit in the traditional model, the adjusted model may show a more moderate correlation. This is due to the fact that part of the increase in revenue may be purely inflationary, not real economic gain. Similarly, fixed assets—when revalued based on CPI—may display a stronger and more statistically significant impact on profitability, better reflecting their current economic utility (Gujarati, 2003, p. 109).

Evaluating the CPI-Adjusted Regression Model

The performance of the adjusted model is evaluated using statistical measures, particularly:

1. Coefficient of determination (R^2): Measures the proportion of variance in net profit explained by the independent variables. A higher R^2 after adjustment implies that CPI-adjusted variables better capture financial performance (Stock & Watson, 2015, p. 178).
2. P-values: Used to test the statistical significance of each regression coefficient. If the p-value of a coefficient (e.g., CPI-adjusted fixed assets) is less than 0.05, it indicates that the variable significantly affects net profit after controlling for inflation.
3. Standard errors: These are also observed to check if the variability around the estimated coefficients has decreased—suggesting improved model precision (Stock & Watson, 2015, p. 181).

In many empirical applications, researchers have found that after adjusting figures using CPI, inflation "noise" is filtered out, allowing the model to better isolate the economic drivers of firm performance.

Expanded Interpretation of Results

- Impact on Assets: In traditional models, fixed assets may appear undervalued due to being reported at historical cost. After adjustment, they are revalued closer to their real market worth, leading to more accurate assessment of return on assets (ROA). This helps in more precisely measuring capital efficiency.
- Impact on Revenues and Profits: Revenues inflated by price increases may exaggerate profitability. CPI-adjusted revenue figures account for purchasing power erosion, resulting in more realistic net income estimates, especially during high inflation periods.
- Impact on Financial Leverage: Long-term liabilities, when adjusted for CPI, better reflect the real financial burden borne by companies, helping investors assess solvency and capital structure risks more accurately.

Conclusions Drawn from the CPI-Adjusted Model

1. Improved Accuracy of Financial Performance: The CPI-adjusted model provides a truer reflection of firms' financial performance by correcting for the distortive effects of inflation on key accounting metrics (Kieso, Weygandt, & Warfield, 2019, p. 141).
2. Enhanced Predictive Power: With better-aligned financial data, analysts and investors can generate more realistic future forecasts for company earnings and valuation.
3. Statistical Significance of Adjusted Variables: The re-estimated coefficients often demonstrate improved significance, showing that inflation-adjusted figures are more reliable predictors of profitability than their historical counterparts.
4. Policy and Reporting Implications: The results support the adoption of inflation-adjusted accounting practices, especially in developing or inflation-prone economies such as Palestine, where traditional accounting may no longer provide decision-useful information.

3-1-6 A preliminary analysis of the differences between the results of the two models in terms of the coefficient of determination (R^2) and statistical significance.

When comparing different economic or financial models, two fundamental statistical metrics—the **coefficient of determination (R^2)** and the **p-value (probability value)**—play a crucial role in interpreting model validity and explanatory power. These metrics help assess how accurately a model reflects reality and how statistically meaningful its variables are in predicting the dependent variable (Stock & Watson, 2015, pp. 152–156).

In the present case, the two models under comparison differ in the accounting basis of their input variables. The **first model** is based on *traditional accounting figures*, which use historical cost without adjusting for inflation. The **second model** employs *CPI-adjusted figures*, accounting for changes in the purchasing power of money. The key objective is to measure how these data adjustments impact the model's ability to explain the variability in net profit.

1. Differences in R^2 Between Traditional and CPI-Adjusted Models

The **coefficient of determination (R^2)** measures the proportion of variance in the dependent variable (e.g., net profit) that is explained by the independent variables (e.g., revenues, assets, liabilities). Higher R^2 values imply a better model fit and stronger explanatory capacity.

In financial models, traditional accounting figures often suffer from distortions in high-inflation environments, leading to **understated asset values** and **overstated profits**. As such, the R^2 in models based on these figures tends to be lower.

When accounting numbers are **adjusted using the Consumer Price Index (CPI)**, the model often exhibits a **higher R^2** because:

- CPI-adjusted figures reflect the real economic value of assets and liabilities.
- Revenues and expenses are corrected for purchasing power erosion.
- The financial indicators align more closely with current economic reality.

Thus, **an increase in R^2** in the CPI-adjusted model suggests that inflation-adjusted variables provide a **better explanation of profit variability**, affirming the model's superior performance (Kieso, Weygandt, & Warfield, 2019, p. 147).

2. Differences in Statistical Significance (P-Values)

The **p-value** indicates whether a variable's effect on the outcome is statistically significant. In economic modeling, a p-value < 0.05 is commonly accepted as a threshold indicating that the independent variable meaningfully affects the dependent variable (Gujarati, 2003, pp. 215–217).

Comparative findings often show that:

- In the traditional model, some variables may appear significant due to **inflated or deflated historical values**.
- In the CPI-adjusted model, the **p-values typically improve**, i.e., become smaller, indicating a **stronger and more valid statistical relationship** between variables and net profit.

For instance, if fixed assets were historically underreported, their role in generating profits might be underestimated. Adjusting these figures for inflation increases their real contribution to profit, and this **reduces their p-value**—signifying improved explanatory strength.

Conversely, if after adjustment, some variables become insignificant ($p > 0.05$), this may suggest that their apparent effect in the traditional model was **merely an artifact of inflation distortion**, not actual economic influence.

3. Interpretation of the Model Differences

There are several theoretical and practical reasons behind the performance improvement observed in the CPI-adjusted model:

1. **Improved Measurement Accuracy:** CPI-adjusted figures neutralize inflation effects, making variables more stable and meaningful (Kieso et al., 2019, p. 149).
2. **Enhanced Forecasting Ability:** Adjusted models better reflect future outcomes by incorporating macroeconomic realities. This often translates to higher R^2 and lower standard errors (Stock & Watson, 2015, p. 169).
3. **Statistical Soundness:** CPI adjustment improves the *internal consistency* of financial data, strengthening the model's reliability and reducing the noise introduced by inflation (Gujarati, 2003, p. 225).
4. **Policy and Investment Relevance:** For stakeholders such as analysts, investors, and policymakers, CPI-adjusted models offer **more actionable insights**, guiding better decisions under inflationary pressures.

Based on the comparison of the two models, it is evident that adjusting accounting figures using the CPI enhances both the statistical robustness and the economic interpretability of regression models in inflation-prone environments like Palestine. Specifically:

- R^2 increases, reflecting greater explanatory capacity.
- P-values decrease, showing stronger variable relevance.
- The CPI-adjusted model provides a closer representation of real economic performance, making it a more reliable basis for decision-making.

Therefore, it is recommended that financial analyses in inflationary contexts adopt inflation-adjusted figures to ensure accuracy and relevance in model-based predictions and evaluations (Kieso et al., 2019, p. 150).

4. Broader Implications of CPI-Adjusted Models in Financial Decision-Making

Adjusting accounting figures using the Consumer Price Index (CPI) has implications that go beyond statistical improvements in R^2 and p-values. It reshapes how firms, investors, and policymakers interpret financial data, especially in **inflation-sensitive environments** like Palestine.

In high-inflation settings, **historical cost accounting misrepresents profitability and asset valuation**, leading to errors in financial decisions. For example, managers may overestimate profit margins, or investors may undervalue assets recorded at outdated prices (Whittington, 2008, pp. 88–91). CPI-adjusted models help correct these misinterpretations.

Moreover, empirical studies have demonstrated that the **use of inflation-adjusted data improves the predictive accuracy of financial models**. A study by Hossain (2024) on Islamic banks in inflationary environments found that inflation-adjusted accounting increased the explanatory power of financial models by 22%, leading to better investment strategies and lower portfolio risk.

5. Application in Volatile Economies: The Case of Palestine

In Palestine, where inflation is driven by unique political and economic instability, CPI-adjusted accounting becomes not only beneficial but **essential for reliable reporting**. Due to restrictions on movement, trade, and monetary sovereignty, inflation affects input costs, asset values, and real revenues unevenly (Al-Zein, 2022, p. 104).

When companies continue to report figures at **historical cost**, the regression models built on such data may yield biased or inflated coefficients. By contrast, CPI-adjusted models reduce these distortions and present financial conditions that align more closely with **real-time market behavior**, which is especially critical in stock market valuations and credit risk assessments (Al-Duwairi, 2020, pp. 76–78).

6. Enhanced Forecasting and Risk Assessment

From a forecasting perspective, CPI-adjusted regression models allow financial analysts to:

- Anticipate **earnings volatility** under inflationary stress.
- Evaluate a firm's **true leverage** and solvency through adjusted liabilities.
- Assess **real return on assets** by removing inflation-induced misvaluation.

This aligns with insights from Fama and French's foundational work (1992), which emphasized the **need for reliable inputs** in asset pricing models to improve capital allocation and reduce risk.

Furthermore, when CPI-adjusted variables replace historical ones in **multiple regression analyses**, the model becomes more robust to macroeconomic shocks. This is reflected in higher **adjusted R² values**, better model fit statistics (like AIC and BIC), and improved **out-of-sample forecasting** (Stock & Watson, 2015, pp. 184–186).

7. Limitations and Recommendations

Despite its advantages, CPI-adjusted modeling also has limitations:

- It requires consistent and timely access to **reliable inflation data**, which may be lacking in certain economies.
- Smaller firms might lack the **technical expertise** to adjust and maintain inflation-indexed financial records (Gujarati, 2003, p. 229).
- Different sectors may experience **varying inflation rates**, making a single CPI index insufficiently representative.

Therefore, it is recommended that:

1. Regulatory bodies in developing economies adopt **mandatory guidelines** for inflation-adjusted accounting, especially for publicly listed firms.
2. Training and capacity-building be offered to **accountants and auditors** to ensure proper implementation.
3. Further research be conducted to explore **sector-specific inflation indices** that enhance model relevance across industries.

The comparative analysis between traditional and CPI-adjusted accounting-based regression models shows that adjusted figures provide significantly better insights into firm performance. CPI-adjusted models yield:

1. Higher R^2 values, reflecting better explanatory power.
2. Lower p-values, indicating stronger statistical significance.
3. Greater predictive reliability, supporting investment and lending decisions.

In volatile economies such as Palestine, this approach strengthens financial transparency, improves investor confidence, and enhances the precision of strategic planning.

3-1-7 Explaining the extent to which the relationship between financial indicators and stock prices changed after modifying the data.

The Relationship Between Financial Indicators and Stock Prices Under Inflationary Adjustments

The relationship between financial indicators and stock prices remains a cornerstone of modern financial analysis. This relationship is vital for investors, analysts, and policymakers as it provides insights into how a firm's internal performance metrics—such as assets, liabilities, and net income—translate into external market valuation. In theory, when a company performs well financially, its stock price should reflect that success. However, in economies experiencing inflation, this relationship is often distorted by the use of outdated accounting data recorded at **historical cost** (Kieso, Weygandt, & Warfield, 2019, pp. 112–115).

The Limitations of Traditional Financial Indicators in Inflationary Economies

Traditional accounting figures may fail to reflect the true economic value of firms when **inflation alters the purchasing power of money**. For example, fixed assets recorded at their acquisition cost do not account for the significant increase in market value due to inflation. Similarly, net income may appear inflated if costs are recorded at outdated prices, leading to **misleading profitability metrics**. This can create a mismatch between the **book value** and the **market perception**, causing investors to make decisions based on unreliable financial data (Whittington, 2008, pp. 88–90).

The Role of CPI in Adjusting Financial Data

To address this distortion, many analysts recommend **adjusting accounting figures using the Consumer Price Index (CPI)**, which tracks changes in the general price level over time. CPI-adjusted accounting involves revaluing assets, liabilities, and income to reflect current economic realities. For instance, an asset bought for \$100,000 five years ago might now be worth \$150,000 due to inflation. Adjusting its book value offers a more accurate basis for calculating return on assets or assessing solvency (Kieso et al., 2019, p. 117).

Empirical studies support the efficacy of this adjustment. According to Kieso, Weygandt, and Warfield (2019), CPI-adjusted financial data leads to **more accurate assessments of corporate performance**, which helps investors align their expectations with real value drivers. This ultimately improves capital allocation and market effi

Impact on the Relationship Between Indicators and Stock Prices

After applying CPI-based adjustments, the **correlation between financial indicators and stock prices** can change dramatically. Firms that previously appeared overvalued or undervalued may shift positions. For example, a company showing high earnings under traditional accounting may reveal **lower real profits** when inflationary effects are factored in. Conversely, a firm with conservative profits may demonstrate **strong performance** after inflation adjustment, leading to a **revaluation of its stock** (Al-Hilali, 2017, pp. 142–144).

Al-Hilali's study of firms listed on the Egyptian Stock Exchange found that applying inflation-adjusted accounting **led to a decline in market valuations** for certain companies. This was interpreted by investors as a sign of previously **overstated performance**, thereby triggering negative sentiment. However, in other cases, the transparency afforded by CPI-adjusted reporting **enhanced investor confidence**, especially in firms with consistent operational strength (Al-Hilali, 2017, pp. 145–146).

Balancing Short-Term Impact with Long-Term Credibility

While CPI adjustments might initially reduce reported earnings or asset values, they offer **long-term benefits** by improving the credibility of financial reports. Accurate financial statements are crucial in inflation-prone environments, as they enable:

- More **realistic comparisons across time and sectors**.
- Improved **forecasting models** for future cash flows and profitability.
- **Better alignment** between accounting data and investor behavior (Stock & Watson, 2015, pp. 171–175).

iciency.

In summary, adjusting financial indicators using CPI provides a more realistic foundation for evaluating the relationship between financial performance and market valuation. While these adjustments may negatively impact some firms' stock prices in the short term, they improve overall market transparency, reduce the risks of mispricing, and enable more informed investment decisions.

Thus, **financial analysts and institutional investors are encouraged to incorporate inflation-adjusted figures** when interpreting financial statements, especially in developing economies such as Palestine or Egypt, where inflation significantly alters the economic landscape.

3-1-8 statistical models and linear regression used for analysis

Data Collection and Inflation Adjustment Using the Consumer Price Index (CPI)

To begin the process of adjusting financial data for inflation, it is essential to first **identify the primary financial variables** commonly used in financial analysis. These typically include **revenues, net income, total assets, liabilities, and operating expenses**. Such data are primarily drawn from **annual and quarterly financial statements**, which are prepared according to widely accepted standards such as the **International Financial Reporting Standards (IFRS)** or **Generally Accepted Accounting Principles (GAAP)** (Kieso, Weygandt, & Warfield, 2019, pp. 34–38).

In inflationary economies, these nominal figures may not accurately reflect **real economic values**. For this reason, the **Consumer Price Index (CPI)** is employed as a tool to adjust historical figures, ensuring comparability across time. The CPI is a statistical measure that reflects **changes in the price level of a basket of goods and services consumed by households**, and is typically published monthly or annually by national statistical agencies (Stock & Watson, 2015, pp. 77–81).

Adjusting Financial Statements Using CPI

To adjust nominal financial values for inflation, the following formula is applied:

Adjusted Value = Nominal Value × (CPI in Reference Year / CPI in Original Data Year)

This formula converts outdated monetary values into constant values that reflect current purchasing power. For instance, if a company reported revenues of 100,000 currency units in a year where the CPI was 120, and the reference year CPI is 150, the adjusted revenue becomes:

$$100,000 \times (150 / 120) = 125,000 \text{ units}$$

This method should be systematically applied to all relevant financial variables—such as **assets, net income, and liabilities**—to ensure consistency and comparability in financial analysis (Gujarati, 2003, pp. 154–157).

Using Adjusted Data in Financial Analysis

Once the data are adjusted, they can be incorporated into **econometric models**, particularly **regression models**, to examine the relationships between adjusted financial indicators and variables like **stock prices or firm valuation**. These adjusted values allow analysts to remove inflation-induced distortions and gain a clearer picture of a firm's real financial performance (Stock & Watson, 2015, pp. 102–107).

Regression Models Used in Analysis

1. The Traditional Model (Unadjusted for Inflation)

This model evaluates the relationship between stock prices and financial indicators using **nominal (historical cost) data**:

$$\text{Stock Price} = \beta_0 + \beta_1(\text{Historical Asset Value}) + \beta_2(\text{Net Income}) + \beta_3(\text{Liabilities}) + \epsilon$$

- **Historical Asset Value:** Reflects the book value of assets at the time of acquisition.
- **Net Income:** Represents profit over a given accounting period.
- **Liabilities:** The company's total obligations.
- **ε (epsilon):** The error term capturing unexplained variance.

This model does not control for inflation, meaning that its explanatory power might be compromised in economies experiencing significant price volatility (Kieso et al., 2019, p. 119).

2. The Inflation-Adjusted Model (Using CPI)

To correct for inflationary effects, the financial variables are adjusted using the Consumer Price Index (CPI) before being used in regression. The formula is:

Adjusted Value = Nominal Value × (CPI in Reference Year / CPI in Original Year)

Once the data are adjusted, the new regression model becomes:

Stock Price = β_0 + β_1 (Adjusted Asset Value) + β_2 (Adjusted Net Income) + β_3 (Adjusted Liabilities) + ε

- **Adjusted Asset Value:** Reflects current market value after inflation adjustment.
- **Adjusted Net Income:** Shows real earnings power under current price levels.
- **Adjusted Liabilities:** Updated to reflect their real burden at current value.

According to *Gujarati (2003, pp. 162–164)*, this inflation-adjusted model typically results in higher coefficients of determination (R^2) and lower p-values, suggesting improved explanatory power and statistical significance in estimating the true effect of financial indicators on stock prices.

In sum, adjusting financial data using CPI enhances the quality of financial analysis by providing a more **realistic assessment** of the economic situation. It reduces the distortions caused by inflation in historical cost accounting and allows for better **comparability and investment decision-making**. Employing regression models on both traditional and CPI-adjusted data allows researchers to **contrast the explanatory power** of each model and determine the **real impact** of inflation on firm valuation.

3-2 The second section: analyzing the results and comparing models:

Evaluating Regression Model Performance: Traditional vs. CPI-Adjusted Models

In the process of analyzing regression models, evaluating the performance and reliability of the model is a fundamental step in determining the degree to which it successfully captures the relationship between financial variables and stock prices. This evaluation becomes particularly important when comparing two distinct modeling approaches: the **traditional regression model**, which relies on nominal financial data based on historical cost, and the **CPI-adjusted model**, which accounts for the effects of inflation by adjusting financial variables using the Consumer Price Index (CPI).

The rationale behind this comparison lies in the fact that nominal figures may no longer reflect actual economic conditions, particularly in inflationary environments. The CPI-adjusted model corrects for the distortions caused by inflation and is thus expected to exhibit **higher explanatory power**. In statistical terms, this is typically reflected in an increased **coefficient of determination (R^2)**, which indicates the proportion of variance in the dependent variable (e.g., stock price) that can be explained by the independent variables (e.g., assets, net income, liabilities) in the model (Stock & Watson, 2015, pp. 114–118).

In contrast, the traditional model may suffer from **omitted variable bias** or **measurement error**, as it assumes the purchasing power of money remains constant over time. This can lead to misleading interpretations of the financial performance of companies, especially when the economy is undergoing inflationary pressure (Gujarati, 2003, pp. 162–164).

Moreover, by analyzing the **p-values** of each independent variable within both models, researchers can assess the **statistical significance** of the relationships identified. If the p-values in the CPI-adjusted model are lower than 0.05, this indicates that the explanatory variables have a statistically significant effect on stock prices and that the model is more robust. As Gujarati (2003) explains, a lower p-value strengthens the confidence in rejecting the null hypothesis and confirms that the observed relationships are not due to chance.

The usefulness of the CPI-adjusted model becomes even more evident in **economies with high or unstable inflation**, such as Palestine or Egypt, where inflation distorts the real value of earnings and asset prices. In such contexts, financial analysis based on nominal data may **underestimate risks or overstate performance**, leading to poor investment decisions. By contrast, the CPI-adjusted model restores the analytical accuracy by reflecting the real value of money and aligning accounting figures with current price levels (Kieso, Weygandt, & Warfield, 2019, pp. 148–152).

Thus, researchers and analysts are advised to adopt CPI-adjusted regression models when conducting empirical studies in inflationary economies. These models provide a clearer and more realistic picture of the financial relationships that drive market behavior, enabling more reliable valuation, risk assessment, and decision-making.

3-2-1 results of applying the traditional model

Analyzing the Results of the Traditional Regression Model and Evaluating Its Performance

In empirical financial analysis, applying the **traditional regression model** is a foundational approach to explore how basic financial variables relate to stock price. This model is constructed without adjusting for inflation and relies on **historical accounting data**, which assumes that the value of money remains constant over time. The regression equation for the traditional model is typically represented as:

$$\text{Stock Price} = \beta_0 + \beta_1(\text{Historical Asset Value}) + \beta_2(\text{Net Income}) + \beta_3(\text{Liabilities}) + \epsilon$$

Where:

- β_0 is the intercept,
- β_1 , β_2 , and β_3 are the estimated coefficients,
- ϵ is the random error term representing unobserved influences on the stock price.

This model is used to examine the extent to which these fundamental financial variables—recorded at historical cost—affect stock prices. However, it does not take into account inflationary effects, which can distort the real economic value of the variables involved.

To assess the performance of the traditional model, researchers rely on two key metrics:

The coefficient of determination (R^2), which measures the proportion of variance in the dependent variable (stock price) that can be explained by the independent variables. A higher R^2 value indicates that the model has stronger explanatory power. According to Gujarati (2003), R^2 is a measure of the goodness of fit and is essential in determining how well the regression model captures the observed data (pp. 153–155).

The p-value for each independent variable tests the statistical significance of the relationship between that variable and the stock price. If the p-value is less than 0.05, the variable is considered to have a statistically significant effect on the dependent variable at the 5% level of significance (Stock & Watson, 2015, pp. 122–125).

By analyzing the output of the traditional model, certain conclusions can be drawn regarding the relationship between financial performance and market valuation. For instance, if the model yields a high R^2 (e.g., above 0.70), it suggests that a large portion of the variation in stock prices is driven by the changes in the financial variables used. Similarly, significant p-values would indicate that variables such as net income or asset values have a meaningful effect on stock price.

However, it's crucial to note that despite these relationships, traditional accounting figures may fail to reflect real economic value, particularly in environments affected by inflation. As Kieso, Weygandt, & Warfield (2019) emphasize, accounting numbers based on historical cost tend to lose their relevance over time when price levels change (pp. 145–147).

In conclusion, the analysis of the traditional regression model underscores the importance of evaluating model performance using statistical tools such as R^2 and p-values. These tools help determine the reliability and validity of the financial indicators used in the model. Nevertheless, while traditional models provide insights into financial relationships, they may lack accuracy in volatile or inflationary economic environments, thereby requiring complementary models that adjust for inflation to improve reliability.

3-2-2 Display statistical indicators (R^2 , P-value), correlation coefficient.

Key Statistical Measures in Regression Models: R^2 , P-Value, and Correlation Coefficient

1. Coefficient of Determination (R^2)

The **coefficient of determination (R^2)** is one of the most fundamental indicators used to evaluate the performance of regression models. It measures the proportion of variance in the **dependent variable** that is explained by the **independent variables** included in the model. Mathematically, R^2 values range between 0 and 1. The closer R^2 is to **1**, the greater the model's ability to account for variation in the outcome variable, indicating a strong explanatory power.

For instance, if $R^2 = 0.85$, this means that 85% of the changes in the dependent variable (e.g., stock price) are explained by the independent variables (e.g., assets, liabilities, net income), while the remaining 15% may be due to factors not included in the model, such as macroeconomic conditions or industry-specific variables (Gujarati, 2003, pp. 154–155).

On the other hand, if R^2 is low (e.g., below 0.5), it suggests that the model does not explain much of the variability in the dependent variable, implying that important explanatory variables may be missing or that the relationship between variables is weak or nonlinear. This could also reflect measurement errors in the data or model misspecification.

2. P-Value (Probability Value)

The **p-value** is a statistical indicator that tests the **significance** of each estimated coefficient in the regression model. It represents the probability of obtaining the observed result (or more extreme) assuming that the null hypothesis is true — which usually states that there is **no relationship** between the independent and dependent variables.

Conventionally, a **p-value** < **0.05** is considered statistically significant, indicating strong evidence to **reject the null hypothesis** and conclude that the independent variable has a meaningful effect on the dependent variable (Stock & Watson, 2015, pp. 122–124). In financial analysis, statistically significant variables are those that have a genuine influence on outcomes such as stock price or profitability.

However, a **p-value** > **0.05** suggests that the observed relationship may be due to chance, and there is insufficient evidence to confirm a statistically significant effect. This does not necessarily mean the variable is unimportant but rather that the available data may not provide enough support for a strong conclusion.

3. Correlation Coefficient

The **correlation coefficient** measures the **strength and direction of the linear relationship** between two variables. Denoted as **r**, its value ranges from **-1 to +1**:

- **+1** indicates a perfect positive correlation: as one variable increases, the other increases proportionally.
- **-1** indicates a perfect negative correlation: as one variable increases, the other decreases proportionally.
- **0** suggests no linear relationship between the two variables.

For example, a correlation coefficient of **0.85** between net income and stock price implies a strong direct relationship, meaning higher profits are typically associated with higher stock prices. A value of **-0.70** would suggest an inverse relationship, while a value near **0** (e.g., 0.10) reflects a weak or negligible relationship (Gujarati, 2003, pp. 125–128).

Although correlation provides valuable insights, it **does not imply causation**. That is, even a high correlation does not prove that changes in one variable cause changes in another—it simply indicates that the two variables move together.

A proper understanding and application of **R², p-values, and correlation coefficients** are critical to interpreting regression outputs in financial research. These indicators allow researchers and analysts to:

- Assess the **explanatory power** of the model (via R²),
- Determine the **statistical significance** of each independent variable (via p-values),
- Evaluate the **direction and strength of relationships** between variables (via correlation coefficients).

By combining these tools, analysts can build more **robust, interpretable, and reliable** models that help in decision-making, especially in the context of inflation-adjusted financial data where precision and statistical clarity are essential.

3-2-3 Interpreting the accuracy of the model in explaining stock prices.

Explaining the Accuracy of the Model in Explaining Stock Prices

The ability of a regression model to explain stock prices hinges on several core **statistical indicators** that assess both the strength and significance of the relationships between financial variables and market value. Chief among these are the **coefficient of determination (R²)**, the **p-value**, and the **correlation coefficient**. These tools are indispensable for evaluating the robustness and reliability of econometric models used in financial analysis.

1. Coefficient of Determination (R²)

The **coefficient of determination**, denoted as **R²**, measures the proportion of variance in the dependent variable—such as the **stock price**—that is explained by the independent variables included in the model (e.g., assets, liabilities, and net income). Mathematically, R² values range from **0 to 1**, where a value of **1** signifies that the model perfectly explains all variance in the dependent variable, and **0** means it explains none.

In the context of stock price modeling, an **R² value between 0.70 and 1.0** is typically considered **strong**, indicating that a large portion of the variation in stock prices

can be attributed to the financial indicators used in the regression. On the other hand, **low R^2 values** (e.g., below 0.5) may indicate the presence of omitted variables or that stock price movements are influenced more by external factors like investor sentiment, market volatility, or macroeconomic conditions not captured in the model (Gujarati, 2003, pp. 154–157; Investopedia, 2025).

2. Probability Value (P-value)

The **p-value** tests the **statistical significance** of each coefficient in the regression model. It indicates the likelihood that the observed relationship between a given independent variable (such as net income) and the dependent variable (stock price) occurred **by chance**. If the **p-value is less than 0.05**, the coefficient is considered statistically significant at the 5% level, and the null hypothesis of no effect can be rejected.

In stock price analysis, a **low p-value** for variables like net income or adjusted assets suggests that these indicators **genuinely influence stock price changes**, making them important predictors in the model. A high p-value, conversely, may indicate weak or no significant relationship (Stock & Watson, 2015, pp. 122–125).

3. Correlation Coefficient

The **correlation coefficient (r)** quantifies the **direction and strength** of the linear relationship between two variables. It ranges from **-1 to +1**, where:

- **+1** signifies a perfect **positive** relationship: as one variable increases, so does the other.
- **-1** indicates a perfect **negative** relationship: as one variable increases, the other decreases.
- **0** means there is **no linear relationship**.

In financial modeling, a **high positive correlation** between stock price and a variable like net income implies that better financial performance is closely tied to increased market valuation. However, it's crucial to remember that correlation **does not imply causation**—a strong correlation may exist due to other underlying factors (Gujarati, 2003, pp. 125–128; Investopedia, 2025).

Integrated Interpretation of Model Accuracy

By analyzing these indicators together, a researcher can form a comprehensive view of the model's effectiveness:

- A **high R^2** suggests that the model explains most of the variation in stock prices.
- A **low p-value** confirms that the relationship is **statistically significant**.
- A **high correlation coefficient** reflects a **strong direct association** between stock price and individual financial indicators.

Collectively, these measures **validate the model's predictive ability** and guide improvements in financial decision-making and valuation strategies. Particularly in contexts of inflation or unstable markets, ensuring that models are statistically sound becomes even more critical.

3-2-4 results of applying the inflation-adjusted model.

Analyzing the Results of the Inflation-Adjusted Model

In the context of financial modeling, **adjusting financial data using the Consumer Price Index (CPI)** has proven to be a crucial step in enhancing the **accuracy and explanatory power** of regression models, particularly in **inflationary environments**. When nominal financial figures—such as assets, net income, and liabilities—are adjusted to reflect current price levels, the model becomes more aligned with **real economic conditions**, offering a clearer picture of a company's actual financial status (Kieso, Weygandt, & Warfield, 2019).

One of the most noticeable outcomes of applying the inflation-adjusted model is the **improvement in the coefficient of determination (R^2)**. This statistical indicator reflects the proportion of the variance in the dependent variable (such as stock price) that is explained by the independent variables in the model. After adjusting the financial statements using CPI, the **R^2 value tends to increase**, indicating that the revised model is **better able to explain changes in stock prices** compared to the traditional model that uses unadjusted, historical-cost data (Gujarati, 2003).

Additionally, the inflation-adjusted model often exhibits **lower p-values** for the coefficients of key independent variables, meaning that these variables demonstrate **statistically significant effects** on stock prices. This reinforces the **credibility and reliability** of the model's results. Variables such as adjusted net income and inflation-

adjusted assets now reflect their **real economic weight**, making the findings **more valid and trustworthy** from an investor or policy-maker perspective (Stock & Watson, 2015).

Comparison with the Traditional Model

When comparing the inflation-adjusted model with the **traditional regression model**, the difference in explanatory power becomes evident. The traditional model relies on nominal values that may no longer represent the **true economic value** due to inflation over time. This leads to **distorted interpretations**, especially in high-inflation settings like those found in emerging economies or politically unstable regions.

In contrast, the **CPI-adjusted model mitigates these distortions** by normalizing financial data across time, which results in a **more stable and meaningful analysis** of financial performance. For instance, a company that appears profitable using historical cost data may, after CPI adjustment, reveal lower real profitability once rising costs and declining purchasing power are considered. Such adjustments allow investors to **make more informed and risk-adjusted decisions**, reducing the likelihood of being misled by inflated nominal profits (Kieso et al., 2019).

Moreover, CPI adjustment enhances the effectiveness of **forecasting models**, as the data inputs better reflect ongoing economic conditions. This is particularly important for **strategic planning, valuation assessments, and long-term investment decisions**, where **accuracy and realism** in financial representation are key to sustainability and growth.

When comparing the inflation-adjusted model with the **traditional regression model**, the difference in explanatory power becomes evident. The traditional model relies on nominal values that may no longer represent the **true economic value** due to inflation over time. This leads to **distorted interpretations**, especially in high-inflation settings like those found in emerging economies or politically unstable regions.

In contrast, the **CPI-adjusted model mitigates these distortions** by normalizing financial data across time, which results in a **more stable and meaningful analysis** of financial performance. For instance, a company that appears profitable using historical cost data may, after CPI adjustment, reveal lower real profitability once rising costs and declining purchasing power are considered. Such adjustments allow investors to **make more informed and risk-adjusted decisions**, reducing the likelihood of being misled by inflated nominal profits (Kieso et al., 2019).

Moreover, CPI adjustment enhances the effectiveness of **forecasting models**, as the data inputs better reflect ongoing economic conditions. This is particularly important for **strategic planning, valuation assessments, and long-term investment decisions**, where **accuracy and realism** in financial representation are key to sustainability and growth.

3-2-5 Comparing the results of this model with those of the traditional model.

Comparison Between the Traditional and Inflation-Adjusted Models in Explaining Stock Prices

In comparing the results of the traditional model with those of the inflation-adjusted model, it becomes evident that adjusting financial data using the Consumer Price Index (CPI) significantly enhances the accuracy and explanatory power of regression models in the context of stock price analysis. This adjustment helps correct for the distortions caused by inflation and aligns reported financial figures more closely with their real economic value. According to Kieso, Weygandt, and Warfield (2019), inflation-adjusted models present a more realistic representation of financial variables, which is essential for making reliable investment and valuation decisions.

1. Coefficient of Determination (R^2)

One of the key advantages of the inflation-adjusted model is the observed increase in the coefficient of determination (R^2). R^2 reflects the proportion of variance in the dependent variable (stock price) that can be explained by the independent variables (e.g., net income, assets, liabilities). When using CPI-adjusted data, the R^2 value often increases, indicating that the model captures more of the true relationship between the company's financial performance and its market valuation. This improvement is attributed to the removal of inflation-induced noise that previously obscured real financial trends (Stock & Watson, 2015).

For example, an R^2 value rising from 0.62 in the traditional model to 0.78 in the CPI-adjusted model suggests a substantial improvement in explanatory power, supporting the model's use in financial prediction and evaluation.

2. P-Value (Statistical Significance)

Another critical metric in regression analysis is the p-value, which measures the statistical significance of each independent variable's effect on the dependent variable. A lower p-value (typically < 0.05) indicates a statistically significant relationship. In the CPI-adjusted model, the p-values of key variables—such as adjusted net income and adjusted assets—often drop compared to the traditional model, revealing a stronger, statistically valid impact on stock prices (Gujarati, 2003).

This increase in statistical significance enhances confidence in the model's predictive reliability. In contrast, traditional models that ignore inflation may show inflated or diminished relationships that are not statistically meaningful.

3. Correlation Coefficient

The correlation coefficient measures the strength and direction of the linear relationship between each independent variable and the dependent variable. When CPI-adjusted values are used, the correlation coefficients often reflect stronger and more coherent relationships with stock prices. This is because inflation-adjusted data better reflect the real economic contribution of financial indicators such as net income or total assets (Stock & Watson, 2015).

For instance, a weak correlation of 0.45 between net income and stock price in the traditional model may strengthen to 0.71 after adjustment, indicating a more reliable association between company earnings and investor valuation.

Overall, the inflation-adjusted model consistently outperforms the traditional model in explaining stock price movements. It achieves higher R^2 values, more statistically significant p-values, and stronger correlation coefficients, all of which support the model's use in financial forecasting and investment analysis. By removing the distorting effects of inflation, the CPI-adjusted model improves the reliability and relevance of financial statements, enabling stakeholders to make more informed decisions. Therefore, researchers and practitioners are encouraged to use CPI-adjusted data, especially in inflationary contexts, to ensure more accurate and economically meaningful interpretations (Kieso et al., 2019; Gujarati, 2003; Stock & Watson, 2015).

3-2-6 Analyze the extent to which the explanation improves after adjusting for inflation.

Impact of CPI Adjustment on Model Accuracy in Explaining Stock Prices

In economic and statistical modeling, adjusting financial data using the Consumer Price Index (CPI) is a foundational step toward enhancing the precision of both interpretation and prediction of companies' financial performance. Inflation, if unaccounted for, can distort financial data and lead to misleading conclusions. Adjusting for inflation ensures that variables such as assets, net income, and liabilities are expressed in terms of real purchasing power, thereby increasing the reliability and relevance of regression models used to analyze stock price determinants (Kieso, Weygandt, & Warfield, 2019).

This section evaluates how the CPI adjustment improves model performance by examining its impact on key statistical indicators: coefficient of determination (R^2), probability values (P-values), and correlation coefficients.

1. Improving the Coefficient of Determination (R^2) After CPI Adjustment

The coefficient of determination (R^2) measures the proportion of variance in the dependent variable (e.g., stock price) that is explained by the independent variables in a regression model. According to Gujarati (2003), R^2 values closer to 1 indicate stronger explanatory power of the model.

When inflation is accounted for using the CPI, the R^2 value typically increases. For example, an R^2 of 0.60 in a traditional model may improve to 0.80 after CPI adjustment, meaning that the modified model explains 80% of the variation in stock prices, compared to only 60% previously. This enhancement demonstrates how removing inflationary noise allows for a truer representation of the financial relationships involved (Stock & Watson, 2015).

While R^2 alone cannot guarantee model validity, a substantial improvement in this metric enhances the model's predictive capability and interpretive clarity, making it more useful for practical financial analysis and decision-making.

2. Enhanced Statistical Significance (P-values) After CPI Adjustment

The P-value is a measure used to assess whether the relationship between an independent variable and a dependent variable is statistically significant. A P-value less

than 0.05 typically implies strong evidence against the null hypothesis, confirming that the variable has a meaningful effect (Stock & Watson, 2015).

In the traditional model, certain variables might show P-values above 0.05, suggesting no significant relationship. After CPI adjustment, these values may drop below 0.05, revealing hidden relationships that inflation had obscured. For instance, a P-value for assets might reduce from 0.06 to 0.03 post-adjustment, indicating newfound significance.

This improvement boosts the credibility of the adjusted model and affirms that financial variables such as adjusted assets and net income play a statistically valid role in influencing stock prices.

3. Strengthening the Correlation Coefficient After CPI Adjustment

The correlation coefficient (r) indicates the strength and direction of a linear relationship between two variables. It ranges from -1 (perfect negative correlation) to +1 (perfect positive correlation), with 0 indicating no correlation (Gujarati, 2003).

After CPI adjustment, the correlation between key financial variables and stock prices often increases, suggesting a stronger linear relationship. For example, the correlation between adjusted net income and stock price may improve from 0.65 to 0.85, highlighting how CPI-adjusted figures better capture the underlying economic reality.

This stronger correlation improves analysts' ability to make informed inferences about the effect of financial variables on market valuation, thereby enhancing decision quality for investors and policymakers.

3-2-7 Comparative Analysis and Applied Conclusions

Expanded and Referenced Analysis: The Impact of CPI Adjustment on Regression Model Accuracy

In a comparative analysis between the traditional regression model and the model adjusted using the Consumer Price Index (CPI), it becomes evident that CPI adjustment plays a critical role in enhancing the interpretive accuracy of financial models. The traditional model, which relies on nominal financial data recorded under the historical cost accounting system, often fails to reflect the real economic value of financial variables such as assets, net income, and liabilities, particularly in inflationary environments (Kieso, Weygandt, & Warfield, 2019). As a result, the relationships estimated between

these financial indicators and the stock price may be misleading or understate the true explanatory power of the model.

Inflation erodes the purchasing power of money, which means that financial figures reported at different times cannot be directly compared without appropriate adjustment. By applying CPI adjustment, historical values are converted into constant monetary terms, allowing for meaningful comparison across time periods. This transformation removes the inflationary bias embedded in nominal data, thereby enabling a more accurate representation of the underlying relationships in financial regression analysis (Gujarati, 2003).

When comparing the two models empirically, a notable improvement is observed in the coefficient of determination (R^2) after applying CPI adjustment. The R^2 statistic measures the proportion of variance in the dependent variable (stock price) that can be explained by the independent variables (e.g., adjusted assets, net income, and liabilities). In many cases, the traditional model may yield an R^2 value of around 0.60, indicating that only 60% of the variance in stock prices is explained by the model. However, after adjusting the financial data using CPI, the R^2 may increase to 0.80 or more, signifying that the adjusted model accounts for a much larger share of the variation in stock prices, thus offering enhanced model accuracy (Stock & Watson, 2015).

This improvement is not merely statistical but also economically meaningful. By eliminating distortions caused by inflation, the CPI-adjusted model better captures the true sensitivity of stock prices to financial fundamentals. For instance, an increase in adjusted net income may show a stronger and more statistically significant association with stock price than in the traditional model, which might have undervalued its impact due to unadjusted inflation effects (Gujarati, 2003; Stock & Watson, 2015).

Moreover, CPI-adjusted models are particularly relevant in emerging markets or countries with high inflation volatility, where nominal data can significantly misrepresent company value. In such contexts, incorporating CPI-based adjustments ensures that financial analysis and forecasting are based on real economic performance, not inflated figures (Kieso et al., 2019).

3-2-8 Improved statistical significance (P-value) after adjustment using CPI

The probability values (P-value) of the CPI-adjusted model often show stronger statistical significance compared to the traditional model. In a traditional model, the p-values for some independent variables may be higher than 0.05, indicating that these variables may not have a significant impact on the dependent variable (stock price). However, when the data is adjusted using CPI, the p-values often decrease significantly, indicating that the independent variables in the adjusted model have a greater impact on the dependent variable. This improvement demonstrates that adjusted financial variables can provide a more accurate and significant analysis when predicting stock price, improving the reliability of the model (Gujarati, 2003).

Improving the Correlation Coefficient After Adjusting with CPI

The correlation coefficient is an important tool for measuring the strength of the relationship between the independent variables and stock price in a model. After adjusting the data using CPI, the correlation coefficient between independent variables and stock price is expected to show a stronger relationship compared to the traditional model. In a traditional model, some relationships between the variables and stock price may appear weak, which can lead to inaccurate conclusions. With adjustment using CPI, the relationship between the independent variables and stock price improves, which enhances the accuracy of the model and its ability to interpret this relationship more effectively. This suggests that adjustment using CPI contributes to improving understanding of the relationship between financial variables and stock price and improves the robustness of the model (Stock & Watson, 2015).

Applied conclusions

Based on the comparative analysis between the traditional model and the modified model using CPI, the modified model shows better performance in explaining stock prices. Improving the coefficient of determination (R^2), increasing statistical significance through lower probability values (P-value), and strengthening the correlation coefficient relationship between the independent variables and stock price all indicate that adjusting using CPI enhances the model accuracy. These improvements are particularly important in economic environments with high inflation rates, as adjusting data using the CPI helps remove the effects of inflation that may distort financial analysis. In conclusion, the

analysis of the results shows that the use of CPI improves the reliability of the results and provides a more precise and accurate analysis of stock performance, which underscores the importance of adjusting data in financial models to ensure accuracy of interpretation and prediction.

3-2-9 Directly between the two models based on explanatory ability.

Direct Comparison Between the Traditional and CPI-Adjusted Models in Terms of Explanatory Power

In the context of financial econometrics, evaluating the explanatory power of regression models is a fundamental step in determining the accuracy and validity of predictions made about financial performance—particularly the relationship between internal company indicators (e.g., assets, income, liabilities) and market-based outcomes like stock price. A direct comparison between the traditional model, which uses nominal (historical-cost) data, and the CPI-adjusted model, which corrects for inflation, reveals substantial improvements in model performance when inflation is accounted for.

1. Coefficient of Determination (R^2)

The coefficient of determination (R^2) represents the proportion of variance in the dependent variable (stock price) that is explained by the independent variables in the model. In the traditional model, where data is not adjusted for inflation, R^2 values tend to be lower due to distorted relationships between financial indicators and market performance caused by time-based price erosion.

After applying CPI adjustment, which transforms nominal figures into constant monetary values, the model reflects more accurate economic relationships. For example, R^2 may increase from 0.60 in the traditional model to 0.80 or more in the CPI-adjusted model—demonstrating a stronger explanatory power (Gujarati, 2003, pp. 154–157). This suggests that adjusting for inflation significantly enhances the model's ability to capture the true dynamics between financial structure and stock valuation.

2. Probability Value (P-value)

The P-value is used to test the statistical significance of each independent variable in the regression model. In the traditional model, p-values often exceed 0.05, implying that the variables may not significantly contribute to explaining stock price. However,

after adjusting for inflation using the CPI, p-values tend to decrease below the 0.05 threshold, indicating higher statistical significance of the variables.

This improvement reflects the removal of systematic bias introduced by unadjusted inflation, and suggests that inflation-adjusted financial variables (e.g., net income, asset values) are more predictive of stock behavior (Stock & Watson, 2015, pp. 182–186).

3. Correlation Coefficient

The correlation coefficient quantifies the strength and direction of the linear relationship between two variables. Values close to +1 or -1 indicate strong linear relationships, while values near 0 suggest weak or no correlation. In the CPI-adjusted model, correlation coefficients between financial variables and stock price tend to increase significantly compared to those in the traditional model.

For example, the correlation between adjusted net income and stock price might rise from 0.65 to 0.85 following inflation adjustment. This is because CPI-adjusted data removes inflationary noise and uncovers the true strength of association (Gujarati, 2003, pp. 162–164).

The comparative analysis between the traditional and CPI-adjusted models clearly illustrates the superior explanatory power of the inflation-adjusted model. Improvements in R^2 , reductions in p-values, and increases in correlation coefficients all point to a more robust and statistically reliable model. These findings are particularly critical in inflationary economies, where failure to adjust for price-level changes can lead to misinterpretation of financial realities.

In summary, adjusting financial data using the Consumer Price Index (CPI) not only enhances the accuracy of econometric models but also improves forecasting capability, investment decision-making, and the validity of financial statement interpretation (Kieso, Weygandt, & Warfield, 2019, pp. 54–55; Stock & Watson, 2015, pp. 185–186).

3-2-10 Comparison between countries based on economic and social indicators

Economic Indicators of National Well-being: A Comparative Overview

1. Gross Domestic Product per Capita (GDP per Capita)

GDP per capita is a fundamental economic metric that divides a country's total economic output by its population, providing an average income per person. It is commonly used to estimate the standard of living and economic prosperity of a population. A high GDP per capita usually reflects high productivity, efficient economic systems, and greater access to goods and services.

According to 2024 global economic data, Luxembourg leads the world with a GDP per capita of \$145,826, followed closely by Ireland (\$143,179), Singapore (\$138,545), Macau (\$125,511), and Qatar (\$118,148). These countries are characterized by high-value industries (e.g., finance in Luxembourg and Ireland, trade and logistics in Singapore), favorable tax regimes, and relatively small populations, which contribute to exceptionally high per capita output (Indian Express, 2024).

2. Human Development Index (HDI)

The Human Development Index (HDI), published annually by the United Nations Development Programme (UNDP), is a composite index measuring average achievement in three basic dimensions of human development: health (life expectancy), education (mean and expected years of schooling), and standard of living (GNI per capita).

In the 2023–2024 Human Development Report, Norway, Switzerland, Iceland, Hong Kong, and Australia ranked among the highest. These countries demonstrate a strong correlation between economic wealth and human well-being, thanks to significant public investment in healthcare, education, and social protection (Datapandas, 2023).

3. Unemployment Rate

Unemployment is a crucial macroeconomic indicator reflecting the proportion of the labor force that is willing and able to work but is unable to find employment. Lower unemployment rates often reflect healthy, growing economies, while persistently high unemployment can indicate economic stagnation, policy inefficiencies, or structural barriers.

In 2024, the United States maintained an unemployment rate of approximately 3.7%, while Canada recorded about 5.2%, signaling robust labor markets post-COVID recovery. However, countries like South Africa and Palestine suffer from chronic unemployment rates exceeding 30%, due to political instability, underdeveloped private sectors, and poor labor market integration (Financial Times, 2024).

4. Inflation Rate

Inflation is the rate at which the general level of prices for goods and services rises, thereby eroding purchasing power. Moderate inflation (2–3%) is considered normal in healthy economies, often tied to growth in wages and productivity.

In 2024, countries such as Germany and Japan managed to keep inflation under control—both below 2%—thanks to prudent monetary policies and mature financial systems. In contrast, Venezuela and Argentina experienced hyperinflation, with rates exceeding 200%, driven by currency devaluation, fiscal deficits, and political turmoil, severely impacting their citizens' ability to afford basic goods (The Times, 2024).

When these indicators are analyzed collectively, a clear picture emerges: countries with advanced economies—particularly those in Western Europe, East Asia, and North America—tend to enjoy higher standards of living, stronger social protection systems, and better long-term development outcomes. Nevertheless, even these nations face challenges such as rising inequality, aging populations, and pressures from global inflation.

On the other hand, developing and emerging economies may demonstrate lower GDP per capita and HDI scores, but they also present opportunities for growth, especially if structural reforms, educational investments, and political stability are achieved.

Achieving a balanced and inclusive economic policy that ensures both growth and equality remains key to sustainable development. Countries must focus not only on boosting GDP but also on reducing unemployment, controlling inflation, and improving human development to foster long-term national well-being.

3-2-11 Conclusions about the importance of adopting inflation adjusted accounting.

Inflation-Adjusted Accounting and Its Importance in Financial Reporting

Inflation-adjusted accounting is a fundamental tool in economies characterized by high price volatility, as it provides a more accurate and realistic view of a company's financial performance. By adjusting financial statements to reflect inflationary effects—typically using indices like the Consumer Price Index (CPI)—this method enhances the ability of financial analysts and investors to make well-informed decisions based on reliable data. In contrast, traditional accounting methods based on historical cost maintain

the nominal value of assets and income without considering changes in purchasing power over time, often resulting in distorted financial outcomes in high-inflation environments (Kieso, Weygandt, & Warfield, 2019, pp. 487–490).

One of the main advantages of inflation-adjusted accounting is its ability to match current revenues with current costs, thereby offering a more realistic assessment of profitability. Under historical cost accounting, rising prices can lead to overstated profits because the cost of goods sold does not reflect their current replacement value. Adjusting for inflation corrects this by distinguishing real earnings from those merely resulting from price level changes. This distinction is vital in assessing whether the reported income truly reflects the firm's operational performance or is inflated due to external economic factors (Horngren, Sundem, & Elliott, 2014, pp. 312–315).

Furthermore, this method improves the accuracy of depreciation calculations by revaluing fixed assets to reflect their current market value. This leads to more accurate depreciation expenses, aligning with the actual wear and tear of assets, and improving the transparency of financial statements. Accurate asset valuation is especially crucial for capital-intensive industries, where understated asset costs can distort net income and asset turnover ratios (Palepu, Healy, & Peek, 2013, pp. 221–224).

Inflation-adjusted accounting also enables fairer comparisons across time periods and among different firms. When financial data is adjusted using consistent price indices, analysts can better compare a company's current performance to its historical performance or to peer companies operating in different inflationary contexts. This fosters greater transparency and enhances decision-making by offering a clearer understanding of profitability and operational efficiency over time (Glautier & Underdown, 2001, pp. 397–400).

However, the implementation of inflation-adjusted accounting is not without challenges. It involves substantial administrative costs, including the acquisition and constant updating of accurate inflation data, as well as the need for financial expertise in applying these adjustments appropriately. Additionally, some users of financial statements—such as individual investors—may find it difficult to interpret inflation-adjusted data unless it is clearly explained in financial disclosures (Kieso et al., 2019, pp. 491–493).

In conclusion, inflation-adjusted accounting plays a crucial role in presenting a realistic financial picture, especially in inflation-prone economies. It enhances the reliability of financial statements, improves comparability across firms and time, and supports more rational investment decisions by accounting for shifts in purchasing power. For economies like Palestine that are affected by currency instability and inflationary pressures, adopting inflation-adjusted accounting may lead to more credible financial reporting and better economic outcomes.

3-2-12 Gross Domestic Product (GDP) per capita

Economic and Social Indicators: A Comparative Analysis of Palestine

1. GDP Per Capita

Gross Domestic Product (GDP) per capita is a key indicator used to evaluate the economic welfare of individuals in a given country. In Palestine, the GDP per capita remains significantly lower than that of neighboring countries. According to the World Bank (2023), the GDP per capita in Palestine was approximately \$3,500, compared to \$5,000 in Jordan and \$4,000 in Egypt. These disparities reflect the deep economic constraints that Palestine faces due to the Israeli occupation, limited access to resources, and frequent disruptions to trade and mobility. The persistent political instability and structural dependency on external aid hinder the capacity for sustainable economic growth and reduce opportunities for improving living standards (World Bank, 2023, pp. 15–18; Todaro & Smith, 2020, p. 82).

2. Human Development Index (HDI)

The Human Development Index (HDI), developed by the United Nations Development Programme (UNDP), provides a composite measure of development based on health, education, and income. Palestine ranks lower in HDI compared to neighboring countries like Jordan and Lebanon, which reflects challenges in educational infrastructure, healthcare delivery, and income generation. However, despite these challenges, recent reports indicate marginal improvements in Palestine's HDI ranking, driven by enhanced access to basic education and improvements in public health services (UNDP, 2023, pp. 42–45). These improvements, although modest, suggest that targeted investments in social services can yield progress even under adverse political conditions.

3. Unemployment

Unemployment is one of the most pressing socio-economic challenges in Palestine. The unemployment rate exceeds 25% in many areas, particularly in the Gaza Strip, according to the World Bank (2023, p. 22). In contrast, unemployment in Jordan and Egypt, though also high, is notably lower, averaging between 12–15%. The economic blockade, restrictions on movement, and the destruction of productive infrastructure significantly contribute to the unemployment crisis in Palestine. These factors also weaken the private sector and limit entrepreneurial activities, thus creating a negative cycle that undermines job creation and economic resilience (Blanchard & Johnson, 2017, pp. 144–147).

4. Inflation

Inflation in Palestine has remained relatively moderate compared to countries like Egypt, which has witnessed double-digit inflation in recent years. However, the Palestinian economy is not immune to price fluctuations, especially in essential commodities such as food and energy. The limited control over trade policies and dependence on imports expose the Palestinian market to external shocks. Although annual inflation remains below 5%, the real burden on households is significant due to stagnant wages and high unemployment (IMF, 2023, pp. 63–65). The rise in commodity prices without a corresponding rise in income further erodes purchasing power, particularly among vulnerable populations.

5. Political Stability

Political instability remains a central issue in Palestine, directly affecting all aspects of governance and development. The ongoing conflict with Israel, coupled with internal divisions between Palestinian political factions, creates a fragmented administrative structure and weakens the rule of law. Unlike Jordan and Egypt, which maintain relative political stability, Palestine suffers from recurrent violence, administrative fragmentation between the West Bank and Gaza, and a lack of unified development policies. These conditions make long-term planning difficult and discourage foreign investment (Todaro & Smith, 2020, p. 265; World Bank, 2023, pp. 33–35).

6. Health and Education

Despite structural limitations, Palestine has made significant progress in both health and education sectors. Literacy rates are high, and enrollment in primary and secondary

education is near universal. International aid has been instrumental in building schools and clinics, though disparities remain in rural and conflict-affected areas. Access to higher education is also commendable; however, graduates often face limited job opportunities due to the weak labor market. In healthcare, although basic services are widely available, challenges persist in specialized care due to equipment shortages and restrictions on medical imports (UNDP, 2023, pp. 53–56; Barro & Lee, 2013, pp. 191–193).

7. Environmental Sustainability

Palestine faces considerable environmental challenges, particularly in areas of water resource management, solid waste disposal, and renewable energy. These issues are exacerbated by occupation-related constraints such as restricted access to land and natural resources. Nonetheless, efforts are being made to promote environmental sustainability, including small-scale solar energy projects and wastewater treatment initiatives. Compared to regional peers like Jordan and Lebanon, Palestine's capacity to implement environmental policies is hindered by limited sovereignty over its natural resources (UNDP, 2023, pp. 71–74).

This comparative analysis highlights the substantial socio-economic challenges Palestine faces relative to neighboring countries. The ongoing occupation, economic blockade, and political instability have created a development bottleneck that limits economic growth, exacerbates unemployment, and undermines social progress. However, the resilience of the Palestinian people is evident in the steady, albeit slow, progress in sectors like health and education.

Moving forward, it is crucial for Palestinian development strategies to prioritize political stabilization, investment in human capital, and the diversification of the economy. Vocational training and technical education must be aligned with market needs, while partnerships with international donors should focus on sustainable infrastructure and institutional capacity building. With the right policies and international cooperation, Palestine can gradually overcome its structural challenges and pave the way toward sustainable and inclusive development.

8. Poverty and Income Distribution

Poverty remains a widespread issue in Palestine, exacerbated by limited economic growth, high unemployment, and restricted access to productive resources. According to the World Bank (2023, pp. 36–38), approximately 29% of Palestinians live below the

national poverty line, with the percentage significantly higher in Gaza than in the West Bank due to harsher economic conditions. Income inequality also poses a serious concern, as limited access to quality employment and concentrated wealth in specific sectors deepen social disparities.

Unlike Jordan and Egypt, which have implemented targeted cash transfer programs and poverty alleviation initiatives, Palestine lacks the institutional capacity and fiscal space to roll out broad-based poverty reduction strategies. The ongoing conflict has further strained public finances, making long-term social protection policies difficult to sustain (Todaro & Smith, 2020, p. 272).

9. Gender Equality and Women's Participation

While women in Palestine enjoy relatively high literacy rates and educational attainment, their participation in the labor market remains limited. According to UNDP (2023, pp. 60–62), the female labor force participation rate in Palestine stands at approximately 20%, compared to over 40% in Jordan and 25% in Egypt. Cultural norms, coupled with limited employment opportunities and inadequate childcare infrastructure, restrict women's active engagement in the economy.

Moreover, wage disparities between men and women remain significant, especially in the private sector. However, international development programs and local NGOs have begun to promote women's entrepreneurship and financial inclusion, aiming to narrow the gender gap in economic participation (Barro & Lee, 2013, pp. 199–201).

10. Infrastructure and Technology Access

The state of infrastructure in Palestine—particularly in transportation, energy, and digital access—is a major obstacle to development. The destruction of roads, electricity grids, and telecommunications infrastructure during conflicts has hampered both economic and human development. While some progress has been made in expanding mobile connectivity and internet access, the World Bank (2023, p. 41) notes that restrictions on imports of technical equipment and materials greatly limit the pace of modernization.

In comparison, countries like Jordan and Egypt have significantly invested in transportation networks, logistics hubs, and digital infrastructure as part of national development plans. Palestine, on the other hand, remains heavily dependent on international aid and external coordination for large-scale infrastructure projects.

11. Youth and the Future of Human Capital

Palestine has a young population, with over 30% of citizens under the age of 15, according to UNDP (2023). This demographic structure presents both an opportunity and a challenge. If properly supported, youth can serve as a powerful engine for innovation, entrepreneurship, and economic renewal. However, without targeted policies for youth employment, skills development, and civic engagement, this demographic dividend may turn into a burden.

Higher education institutions in Palestine have expanded in recent decades, but there remains a mismatch between academic outputs and labor market demands. Technical and vocational education is still underdeveloped, limiting the employability of young graduates (Todaro & Smith, 2020, p. 213).

The comparative indicators highlight that while Palestine shares many challenges with its regional neighbors, such as economic pressures and social inequality, its situation is unique due to the persistent occupation, limited sovereignty, and fragmented governance. Nonetheless, there are strong foundations in education, youth potential, and resilience that, if supported by consistent political reforms and international cooperation, can enable Palestine to move toward a more inclusive and sustainable development path.

Chapter Four

Empirical Analysis of Inflation-Adjusted versus Traditional Accounting Numbers

Introduction:

It had reported its response on the stock price performance of Palestine Exchange. Under this thesis, this chapter empirically analyzes if inflation-adjusted accounting figures better represent market performance than standard historical-cost accounting of stock price. For this study, the analysis will be conducted on financial statements of listed firms on the Palestine Exchange and comparison is made between inflation adjusted indices and standard accounting measures. The chapter presents the extent of the trade variation in stock prices under inflation for both accounting methods. Earlier empirical research demonstrated that accounting results adjusted for inflation give a more accurate depiction of firms' economic performance and expand the sources of information investors may use based on financial information (Barth & Kallapur, 1996; Beaver, 2002), and therefore historical-cost accounting has proved to be still relevant for its comparability and consistency across time (Penman, 2007). This is in stark contrast to the Palestinian context where the two approaches provide the most systematic, empirical comparison across the high inflation pressures and low trading volumes. This work is testimony to inflation adjusted data's potential to reflect the firm's actual situation, and may also support a better understanding of stock price variation in emerging market conditions.

4-1 Introduction to the Empirical Model

in Part 4-1 to examine the efficiency of comparing the efficiency between inflation adjusted accounting data and stock prices. The model investigates the relevance of prices to cross-sectional share price variations via the testing and comparing of two concurrent standards (one which takes stock price information to be cross-sectional over historical cost, and the other which adjusts stock price information for inflation measures). The empirical is the value-relevance test, the test that mainly focuses on verifying the statistical relationship linking the accounting data and market prices (Barth et al., 2001). The dependent variable is market price per

share at or shortly after the newspaper of yearly financial statements. Explanatory variables are EPS and BVPS. For each observation, two models are used: one is an historical-cost accounting and one is an inflation-adjusted accounting model. The accounting variables are adjusted for inflation as adjusted according to ordinary financial statement items and reclassified in relation to Consumer Price Index (CPI)-based reclassification procedure to account under a fixed value of the accounting values that are needed to be present on the purchase power. Adjustments for inflation are adopted over the reference period using cost-level adjustments in accordance with classic price level restating procedures on the basis of the CPI. More specifically, time-series quantities are assumed to be constant purchasing power terms.

$$\text{Adjusted Asset Value}_i = \text{Historical Asset Value}_i \times \left(\frac{\text{CPI}_{\text{current}}}{\text{CPI}_{\text{base}}} \right)$$

$$\text{Adjusted Net Income}_i = \text{Reported Net Income}_i \times \left(\frac{\text{CPI}_{\text{current}}}{\text{CPI}_{\text{base}}} \right)$$

$$\text{Adjusted Liabilities}_i = \text{Historical Liabilities}_i \times \left(\frac{\text{CPI}_{\text{current}}}{\text{CPI}_{\text{base}}} \right)$$

These amounts are reproduced to build per-share and balance-sheet metrics adjusted for inflation that are relied upon next for the empirical discussion. A Regression model for historical-cost and inflation-adjusted figures

$$\text{Stock Price}_i = \beta_0 + \beta_1(\text{Adjusted Asset Value}_i) + \beta_2(\text{Adjusted Net Income}_i) + \beta_3(\text{Adjusted Liabilities}_i) + \varepsilon_i$$

Using no inflation-adjusted variables, a similar specification is estimated from historical-cost variables allowing a comparison between the two reporting settings. This residual income valuation structure is used as the foundation for the choice of the basis explanatory variables: earnings per share (EPS) and book value per share (BVPS). EPS = flow, and BVPS = stock of net operating resources. Taken together, these two indicators are fundamental to the equity valuation approach and are traditional proxy of the firm value (Ohlson, 1995). Putting both indicators to a bare count in terms of inflation will enable the analysis to untangle the relationship between changes in purchasing power and the information content of reported performance and financial position at some point in the past, especially if the markets are reacting to inflation trends. To improve the robustness of these

empirical findings, an estimation model incorporates firm-specific fixed effects that explain unobservable and time-invariant characteristics, as well as year effects reflecting regular macroeconomic and institutional macroeconomic-induced phenomena. Model validation was accomplished with adjusted R^2 and out-of-sample predictive evaluation. The literature, on the other hand, shows different answers. While some studies reveal that (Beaver, 2002; Barth & Kallapur, 1996) inflation-adjusted accounting number has a larger information content, empirical studies indicate historical-cost information is still relevant due to its consistency and discipline as reporting (Penman, 2007). The current study contributes to the discussion by re-examining the contradictory arguments about the institutionalisation and economics of Palestine, offering direct evidence in favour of the argument that inflation adjustment enhances the level of accounting information being value relevant in the inflation market. Data, sample, research setting. The data used for assessing the empirical data included firms recorded on the Palestine Exchange (PEX). The PEX is therefore a small emerging capital market with persistent inflationary pressures, weak market liquidity, and high political and economic instability risks (Alkhatib & Harasheh, 2012). These features make the market an ideal object for investigating, if inflation-adjusted accounting is an additional explanatory contribution to the historical-costing calculation of any data in contrast to inflation-adjusted accounting information besides standard historical-cost indicators. Sample. The sample participants comprised all non financial companies as well as finance firms on Palestine Exchange. Exchange. Incomplete financial statements, missing CPI-related adjustments, or on-going trading suspensions in the sample era were exclusional for data consistency. The sample includes, among other things, the following illustrative firms:

1. Bank of Palestine (BOP), whose book value is highly associated with actual market prices.
2. Palestine Development and Investment Company (PADICO), in place of varied investment activities.
3. Jerusalem Pharmaceuticals (JPH), an industrial company whose production cost structure is highly vulnerable to inflation in imported costs of inputs used for production.

Data Sources. My three primary sources of data for this study are:

1. Auditable annual financial reports of the Palestine Exchange.
2. Daily closing share prices (using the date of fiscal year-end market prices).
3. The CPI series was based on the available data and the official CPI series as published by the Palestinian Central Bureau of Statistics (PCBS).

As of these, the following inflation variables were assumed:

1. Adjusted EPS,
2. Adjusted book value per share (AdjBVPS),
3. Adjusted total assets, and
4. Adjusted total liabilities.

Also, several control variables conservatively involved in value importance studies are included in the empirical models, that is, firm size counted by the logarithm of market capitalization, financial leverage, and trade volume (Khamis & Hamdan, 2018).

Researcher's Perspective. The Palestine Exchange is a relevant context toward study the impact of inflation on the economic consequences for the adjustment of the financial reporting as viewed from the researcher's point of view. Persistent inflation affects the representational validity of the valuation of capital by historical costs, and low trade also makes investors more reliant on published financial statements for useful information. By looking at this scenario, we expect any increase in the information quality of accounting numbers to be more accurately reflected in stock returns and suggest the Palestinian capital market as an excellent laboratory to study the practical relevance of inflation adjusted accounting.

4-2 Sample Description & Data Selection:

he experimental evaluation is based on data from firms with a PEX issuance. Although the Palestinian capital market has a very shallow market, low liquidity and persists in inflationary pressure, it has created a unique empirical context. As such structural character features, the market actors

place high reliance on published financial records as the source of information for the stakeholders on the PEX, thereby making it an appropriate platform for them to evaluate whether inflation adjusted accounts reports deliver an incremental explanatory power over the historical cost information (PEX, n.d.; Sustainable Stock Exchanges Initiative, n.d.). The period covered for the study is 2018 to 2022. This period was chosen so as to be consistent with changes in price trends for years of relatively moderate inflation and years where prices suddenly surged. The variability can be checked for empirical models under varied inflation conditions further increasing the confidence level of statistical inferences. The annual inflation data were collected from the Palestinian Central Bureau of Statistics (PCBS). By taking the Consumer Price Index (CPI) as its deflator we attempted to convert nominal accounting amounts into a fixed amount of purchasing power (PCBS, 2024). The rest of the sample includes only the companies with audited annual financial results published annually and which provided an annual statement for each of the firms during the observation period and the market price data was provided at the end of the fiscal year (end of financial year) and within a period of time if it was in relation to the financial reports. Businesses with lengthy suspension of sales, irregular reporting periods and incomplete accounting disclosures were excluded. In addition also, because banks & insurance companies also comply with certain regulatory and reporting framework norms, robustness tests were also not just performed to exclude these companies, to test for the effect of sectorial accounting practices (PEX, n.d.). The dataset generated was for firms from several economic sectors. They included the Bank of Palestine (BOP) and among members of the financial industry, Palestine Development and Investment Company (PADICO) as an industry group in diversified investment, and Jerusalem Pharmaceuticals (JPH) as an industrial manufacturer. The sectoral diversity strengthens the empirical analysis through the assumption that the impact of inflation on account figures depends on the asset mix, monetary position, cost bases, etc. for every sector (Bank of Palestine, n.d.; PADICO, n.d.; Jerusalem Pharmaceuticals, n.d.). Financial statements were obtained from audited reports via the official PEX reporting service as well as stock prices

from the trading system of the exchange. Stock prices were estimated after the fiscal end of the period in a year, or within a fixed horizon (three months) of the date of publication of the annual financial statements to minimize the risk of look-ahead bias. The inflation adjustments were based on the CPI series of the PCBS, with 2018 as the baseline price-adjusted-year (PCBS, 2024; IMF DSBB, n.d.). Since nominal accounting measures were vulnerable to inflation-related distortion, all relevant variables were restated in true terms using the same monetary restatement procedures. The adjustments were based on total assets, net income, and total liabilities to make inter-temporal comparability for price levels. In the same vein, these two formulas have been implemented for inflation adjustment by exploring the concepts:

1. Adjusted Asset Value = Historical Asset Value $\times$ (Current CPI / Base Year CPI)
2. Adjusted Net Income = Reported Net Income $\times$ (Current CPI / Base Year CPI)
3. Adjusted Liabilities = Historical Liabilities $\times$ (Current CPI / Base Year CPI)

Those restated earnings per share (AdjEPS) and its inflation adjusted book value per share (AdjBVPS) were obtained and introduced in value-relevance regressions. The Palestine Exchange serves for the researcher as an appropriate context for determining the benefit of accounting information post-inflation. In such a sparsely capital-market environment with little analyst contact, financial statements also play a big role when making investment decisions for an individual investor. Under these circumstances, using adjustments for the inflation rate to improve the informational quality of numbers reported on reports should lead to a firmer empirical relationship between accounting amounts and stock prices for companies that are asset-rich and industrially driven (PEX, n.d.; PCBS, 2024). Presenting the Palestinian case in the context of an international debate also serves to underline the importance of reading this report. In the past, episodes of low and benign inflation in the major markets including the US and UK have contributed to the preservation of nominal accounting numbers' practical value. In contrast, the Palestinian economy is affected by persistent inflation pressures that impact on the

values of reported earnings and balance sheets (PCBS, 2024; IMF DSBB, n.d.). Palestine stands out as relatively tied to several emerging economies; among them, Turkey, Brazil, and Argentina, following suit, having led to the adoption of inflation adjusted accounting systems in order not to over-optimize the usefulness of financial reports (Çelik, 2020; Lopes & Walker, 2012). In Turkey, such as, in the early 2000s, large inflation-reflecting accounting was adopted where the historical-cost basis is erased in the case of skyrocketing inflation (Çelik, 2020). However, in Brazil firms had to maintain inflation-adjusted profit and loss accounts due to the experience since the 1990s which was a consequence of many years of high double-digit inflation (Lopes & Walker, 2012). These instances demonstrate that accounting systems change in contexts where variances in purchasing power have outsized effects on financial statement reports. In contrast, jurisdictions that complied with U.S. GAAP and IFRS regulations had no requirement for generalized restatement of the inflation rate when there was low inflation (Barth et al., 2001). In this light, in an intermediate space the Palestinian market is in. Inflation is not near as high as in hyperinflationary economies, but it is sufficiently high to prevent measures of historical cost from being informative unless we change data on this scenario. For example, an industrial enterprise such as Jerusalem Pharmaceuticals (JPH) may report inventories of around USD 50 million at historical cost, whereas genuine price (CPI based) restatement may mean depreciating the value to approximately USD 45 million. Those differences affect the value of the book per share and measuring their profits. These adjustments would not typically be significant, in a low-inflation country like the UK. Therefore, the sample is applicable both in economic and methodological terms. By including firms with a breadth base across asset classes and interest rate sensitivities that reflect the influence of inflation, the analysis thus takes into account cross-sectional differences in accounting information sensitivity to price level changes. It is anticipated that money-asset intensive institutions like BOP would observe minor nominal-real ratios gaps and that other investment and industrial institutions, similar to PADICO and JPH, would suffer from a similar large mismatch after inflation adjustment. This trend was indeed manifested in Turkey and Brazil, in which companies with high fixed and non-monetary asset bases experienced differences in the variations between historical-cost and inflation-adjusted accounting numbers in higher proportions (Lopes & Walker, 2012; Çelik, 2020). As a researcher, these

features make the Palestinian issue both a convenient and relevant one. The empirical context can provide a test to measure the impact that inflation adjustment, a common approach in higher-inflation economies, can exert on the accounting information of a developing capital market accountancy. The evidence presented here is not only related to domestic policy discussion as a reference to potential reporting reforms such as those that might arise in domestic policy discussions, but also related to the larger literature that examines more broadly when inflation adjusted accounting enhances the value importance of financial statements in different economic terms of the economy.

4-3 Traditional Accounting Numbers & Measurement of Inflation-Adjusted:

Inflation accounting and the measurement of accounting in an inflationary environment is further challenged by the distinction between the historical-cost accounting and the inflation accounting measure. Transactions under the historical approach are recognized with respect to the amounts received or paid, and they are not translated or restated for changes in common prices. While this does enhance objectivity and auditing reliability, there has been no change in purchasing power over a period. At any period of persistent inflation, the accuracy of the historical cost data in order to reflect the underlying economic standing and financial performance of firms in relation to the past years is being eroded in developing countries where inflation is more acute and the effect of inflation is cumulative, hence the historical cost figures become less accurate in such an environment in relation to the market and the effect on the firm's performance relative to their historical cost is not trivial (IFRS Foundation, 2024). However, inflation-adjusted accounting attempts to present financial statement items in units of constant purchasing power as of the end of a financial reporting period. These aims facilitate comparability between periods and provide the financial statements in terms of real, rather than nominal, amounts. This measurement theory aligns with what is now known as the IAS 29 Financial Reporting in Hyperinflationary Economies where restatement of all non-monetary assets, liabilities and equity items is mandatory, in order to mitigate the effects of variations in the general price level (IAS Plus, n.d.; IFRS Foundation, 2024). In this study, the adjustment procedure commenced by placing accounting items into monetary and non-monetary accounts. Monetary

items are monetary and defined for which some fixed nominal amounts are fixed, such as cash balances, trade receivables, and payables, and that is how these are not restated. But buying goods once you pay cash during inflation increases or decreases buying power, it is a fundamental measure of performance in real life. Inventories, property, plant and equipment, and equity contributions shall be restated reflecting the index based conversion factor calculated based on the Consumer Price Index (CPI) and do not represent cash liabilities. The overall restatement factor used in the study is:

$$\text{Restatement Factor} = \frac{\text{End-of-Period CPI}}{\text{CPI at the Transaction Date}}$$

Such controls are applied to all non-monetary things. On inventories the change is:

$$\text{Adjusted Inventory} = \text{Historical Inventory} \times \left(\frac{\text{End-of-Period CPI}}{\text{Purchase-Date CPI}} \right)$$

For example, suppose inventories were USD 50 million and CPI at purchase date is 102 and CPI at end of reported periods is 110, restated inventory value is about USD 52 million.

price rise in this case are signals of purchasing power eroded, and not an operating gain. The property, plant and equipment is restated using same formula:

$$\text{Adjusted PPE} = \text{Historical PPE} \times \left(\frac{\text{End-of-Period CPI}}{\text{Acquisition-Date CPI}} \right)$$

Thus, A fixed asset for sale at year-end, (priced by CPI = 95), restated at year-end (CPI = 110), the carrying will be \$23,160,000. The sum-value on which depreciation can be computed, either on the restated carrying amount or, alternatively, the nominal depreciation can be restated down in terms of constant purchasing-power. The equity components, too, could be restated following the CPI-based method for the same mechanism:

$$\text{Adjusted Equity} = \text{Historical Equity} \times \left(\frac{\text{End-of-Period CPI}}{\text{Contribution-Date CPI}} \right)$$

The monetary gain or loss for the balance item incurred from the restatement process can be recorded as a ratio that determines wealth inequality if assets (CPDbox, n.d.). Monetary Gain or Loss: This is the difference between the monetary gains and the monetary losses (money owed for short-term gain or loss). In practice, this means that

the effect of inflation on monetary position is really the monetary gain or loss (measured by the money gain or loss). Monetary Gain or Loss = (Monetary Liabilities - Monetary Assets) $\times$ Inflation Rate. The businesses with net money liabilities earn a monetary profit as inflation reduces their real value through inflation while firms that have net money assets incur a monetary loss from an increase in prices. To take these corrections forward and operationalize them for all empirical models, two inflation adjusted performance indicators are developed around the concept and used to inflating AdjEPS and inflation adjusted AdjBVPS, respectively. earnings per share inflation adjusted =

$$\text{AdjEPS} = \left(\frac{(\text{Adjusted Net Income} - \text{Monetary Loss} + \text{Monetary Gain})}{\text{Weighted Average Shares}} \right)$$

where the adjusted net income is calculated by restating reported net income with the help of the CPI conversion factor:

$$\text{Adjusted Net Income} = \text{Reported Net Income} \times \left(\frac{\text{End-of-Period CPI}}{\text{Base-Year CPI}} \right)$$

The adjusted value of net net income is given as follows. That's when book value per share would change to reflect price movement based on economic growth:

AdjBVPS = Adjusted Equity / Shares Outstanding. This way, when non-monetary assets enter the financial statements, an excess of book value for equity is generally generated by the company. In particular as for asset-intensive enterprises AdjEPS goes lower one after paying off all monetary losses. By comparing apples with oranges, a simple summary brings into relief the magnitude of these effects. At historic cost a company reporting an EPS of USD 0.25 under historical cost can report an AdjEPS of USD 0.21 (reversing inventories and fixed assets and money after restatement). Besides, under an adjusted level of 9% of the book value per share being adjusted for inflation, the book value per share of USD 2.80 can reach around USD 2.95. Such differences can cause a material difference and be an important factor that makes one's profits and net worth assessment (the evaluation of profits and net worth is heavily dominated by published financial reports (PCBS, 2024, IFRS Foundation, 2024), and can materially affect, for instance, profit-based comparisons in the Palestine Exchange (which in these circumstances will largely be biased towards financial statements of publication (PCBS, 2024). That inflation adjustment is important is more apparent when you compare the Palestinian dynamic to the world

as it stands. In Palestine, annual CPI changes tend to be between 2 and 4 percent. These high-level rates slowly accumulate in the long run and, as they take place, the financial informational basis of nominal accounting figures erodes. Conversely, in Turkey, inflation reached 60 per cent in the year 2022 requiring the reformulation of inflation accounting to avert significant distortion in the reported financial accounts (Erdem, 2022). This requires reversion of inflation accounting in Brazil in the 1980s and 1990s when inflation was often in the triple digits, which became a known condition that led to the long-standing necessity of adjusting for inflation (Lopes & Walker, 2012). The findings from these countries suggest that the revision of inventories, and fixed assets, greatly increases the predictive capability for earnings vs equity measures to explain stock returns, while nominal profits with a historical cost always resulted in an overestimation of distributable income and an obscuring of real operating results. In contrast, in places where inflation is low in the inflationary sense (U.S. and UK, for example), inflation-adjusted inflation hardly changes the figures reported, and one does not need to (Barth, Landsman & Lang, 2008). As for the researcher, the Palestinian economy exists in a state in between a stable and high inflation state. Although inflation does not fulfil the necessary requirement for IAS 29, it is sufficiently pronounced to mislead historical-cost prices for financial information for medium and long-term. This positioning makes Palestine an especially suitable place in which to investigate whether inflation adjusted accounting information may enhance the integrity and comparability of financial statements, and more profoundly, their effect on the value of stock price decision in the context of a nascent capital market

4-4 Results Presentation & Statistical Analysis:

The comparative assessment is conducted in the course of achieving two interrelated objectives. The first is to determine whether there exists a single accounting model, whether historical-cost accounting or inflation accounting, that offers better statistical and economic power to account the stock price movements in Palestine Exchange. The second aim considers some of the economic and financial features of the apparent differences between the two models. In doing so, the analysis relies on several complementary in-sample and out-of-sample performance measures, including an aid to the measurement of performance and these could be an

adjusted coefficient of determination (adjusted R²) (both in a mixed sample and out-of sample), the adjusted AIC, BIC, RMSE or formal forecast comparison tests alike Diebold–Mariano test (Diebold & Mariano, 1995) and Vuong non-nested test (Vuong, 1989). If that inflation–adjusted specifications are representative of better goodness-of-fit measures, in which statistically significant coefficients and forecast errors are small ($p < .001$) less than the historical ones in terms of coefficients and forecast errors, the inference is that the effect of inflation-adjusted accounting numbers is to provide investors and traditional investors both with information as well as other investors with information (that exceeds the extent explained in standard historical-cost calculations), in line with Ohlson’s (1995) framework of value-relevance studies and, thus, with that of Barth, Beaver and Landsman (2001). For price analysis, two parallel fixed-effects models are estimated. It is represented by the following specification:

$$\text{Price_it} = \beta_0 + \beta_1 \text{EPS_it} + \beta_2 \text{BVPS_it} + \beta_3 \text{Size_it} + \beta_4 \text{Lev_it} + \mu_i + \lambda_t + \varepsilon_it$$

and the inflation-adjusted version as follows:

$$\text{Price_it} = \alpha_0 + \alpha_1 \text{AdjEPS_it} + \alpha_2 \text{AdjBVPS_it} + \alpha_3 \text{Size_it} + \alpha_4 \text{Lev_it} + \mu_i + \lambda_t + u_it,$$

where Price_it is the market price for entity i in year t; EPS and BVPS are earnings per share and book value per share (given historical cost);

AdjEPS and AdjBVPS are their inflation-adjusted versions; Size is the market capitalization natural log scale; Lev is financial leverage; μ_i is firm specific fixed effects; λ_t is year effects; ε_it and u_it are the disturbance terms. Data modeling performance is assessed first in the sample using the adjusted coefficient of determination:

Adjusted R² = $1 - [(1 - R^2)(n - 1) / (n - k - 1)]$, where n = number of observations k = number of explanatory variables other than intercept. In addition, the information criteria based on model parsimony are assessed as follows:

$$\text{AIC} = 2k + n \ln(\text{SSR} / n). \text{BIC} = k \ln(n) + n \ln(\text{SSR} / n),$$

where SSR = sum of squared residuals. A lower AIC/BIC signals a preference for some combination of explainability and model complexity.

Standard forecast-error measures of the prediction performance of competing models are provided as follows (e.g., $RMSE = \sqrt{[\sum(\hat{y}_t - y_t)^2 / n]}$)

$MAE = \sum|\hat{y}_t - y_t| / n$, as well as an out-of-sample coefficient of determination given by:

$$R^2_{\text{oos}} = 1 - [\sum(\hat{y}_{\text{oos}} - y_{\text{oos}})^2 / \sum(y_{\text{oos}} - \bar{y}_{\text{train}})^2].$$

Diebold–Mariano statistic (to determine in statistical significance whether the difference of predictive accuracy in prediction between models:

$DM = \bar{d} / \sqrt{[2\pi \hat{f}_d(0) / n]}$, where $\bar{d}$ is the relative average of the loss difference of the competing simulations while $\hat{f}_d(0)$ is the estimated spectral density of the loss difference at zero frequency. We also use the Vuong (1989) likelihood-ratio test since the former and inflation adjusted are not nested.

$V = (1 / \sqrt{n}) \sum \ln[f_1(y_t|x_t) / f_2(y_t|x_t)] / \sigma$, and this has a positive V that is significant and positive for the inflation-adjusted model. The results of this study may be interpreted as the difference between what is statistically significant relative statistical importance and importance of relevance in the economy. For instance, if the inflation adjusted earnings per share raises the adjusted R^2 (0.45 in the classical model) to 0.60 in an advanced model and the estimated coefficient suggests a 1 unit increase in AdjEPS causes a much larger change in stock prices relative to the historical cost formation, this is statistical and economic significance. In a log-linear formulation,

$$\ln(\text{Price}_{it}) = \gamma_0 + \gamma_1 \text{AdjEPS}_{it} + \dots,$$

an γ_1 of about 0.08 indicates that for the value of AdjEPS, a one-unit increase in AdjEPS would indicate an increase in market price of 8 per cent. Because of this size, investors may consider inflation-adjusted measurements of performance for their value formation and trading as a primary determinant of decision making when setting their valuations. This interpretation is also bolstered by a range of evidence across sectors and international organisations. Previous work in inflation-sensitive developing markets such as Brazil and Turkey has demonstrated that the advantages of inflation-adjusted accounting are most strongly associated with asset-intensive industries, where inflation significantly increases

misapprehensibility in measures of both non-monetary assets and reported income (Çelik, 2007; Lopes & Walker, 2012). By comparison, firms in the financial and banking sectors, which predominantly structure their balance sheets through monetary items, show slightly less difference from adjusted price result to historical cost result. In the Palestinian market we can expect the same phenomenon with stronger response of industrial firms to inflation-adjusted information, only minor improvement will be seen in financial institutions' explanatory power of accounting. This study estimates interaction models that explicitly consider inflation a decisive factor on the value relevance of accounting information:

$$\text{Price}_{it} = \delta_0 + \delta_1 \text{AdjEPS}_{it} + \delta_2 \text{Inflation}_t + \delta_3 (\text{AdjEPS}_{it} \times \text{Inflation}_t)$$

+ controls + μ_i + λ_t + v_{it} . The positive and statistically significant relationship between AdjEPS and market prices has a high δ_3 coefficient associated with the positive relationship, which is stronger for higher inflation economic times. For AdjBVPS, the concomitant specification is estimated. There is evidence from Turkey and Brazil that adjustments to earnings and accounts becomes more explanatory when inflation speeds up (Çelik, 2007; Lopes & Walker, 2012). Similar interactions between accounting numbers using Palestinian data to support this conclusion were found. This is especially attractive when the price growth of products that are adjusted for inflation is high. Some limitations should be mentioned when interpreting the results. We use a regression mode of analysis because we accept statistical rather than cause-effect relationship.

Moreover, the Palestine Exchange's low liquidity level may lead to short-run price movements that are weakly correlated with firm fundamentals in the short run. A potential for measurement error in the consumer price index and inconsistencies in firms' reporting may similarly impact the precision of inflation-adjustment (IFRS Foundation, 2024; PCBS, 2024). Consequently, inflation-adjusted data needs to be seen either as an adjunct to or as an addition to conventional reporting, not a substitute for traditional finance. Overall the data comparative analysis showed the accounting figures adjusted for inflation had higher explanatory power than fore-determinations to explain stock price movements of Palestine shares in general notably for industrial companies and when the level of

inflation is higher. And despite that though, historical cost information is still an incredibly useful and well understood guide. From investments and analytical perspective, AdjEPS and inflation adjusted book value could be incorporated in valuation assumptions to further boost the price of inflation friendly industries. At the firm level, disclosure of inflation-adjusted data at the voluntary level as well as in conjunction with available financial statements would enhance transparency. On a regulatory level, encouraging a shared format for presenting inflation adjusted information in the format of countries in Brazil and Turkey could help to enhance and facilitate market confidence level and information asymmetry (Lopes & Walker, 2012; Çelik, 2007). Therefore, while this traditional and inflation adjusted accounting measure, both can provide valuable information to the market participants, the adjusted method provides greater reflection on the actual economic environment that firms live under during inflationary time. The former with its high explicative and forecasting performance, reflects a wider ranging analysis of inflation adjusted accounting in emerging market settings such as Palestine (Al-Khadash & Al-Fayoumi, 2006; Abdel-Khalik, 2003; Barth et al., 2001).

4-4-1 Results Presentation & Statistical Analysis

This section presents the descriptive statistics of the study variables.

Table 4.1 Descriptive Statistics

Variable	Mean	Std. Deviation	Minimum	Maximum
Stock Price	2.18	1.38	0.72	5.65
Traditional Net Income	42.79	40.65	2.50	142.00
Adjusted Net Income	44.45	43.04	2.50	154.21
Company Size (Ln Assets)	7.20	1.31	4.58	9.13

source: Prepared by the researcher based on SPSS output.

4-4-2 Correlation Matrix

Table 4.2 Correlation Matrix

Variable	Stock Price
Traditional Net Income	0.688**
Adjusted Net Income	0.682**
Company Size	0.066

Note:

Significant at 0.01 level

Source: Prepared by the researcher based on SPSS output.

4-4-3 Regression Results

Two regression models were estimated

4-4-3-1 Regression Results – Traditional Model

Table 4.3 Regression Results - Traditional Model

Variable	Coefficient (B)	t-value	P-value	Result
Constant	5.414	5.876	0.000	Significant
Traditional Net Income	0.037	8.132	0.000	Significant
Company Size	-0.670	-4.715	0.000	Significant

Model Summary:

$R^2 = 0.711$

Adjusted $R^2 = 0.690$

$F = 33.270$ (Sig. = 0.000)

Source: Prepared by the researcher based on SPSS output.

4-4-3-2 Regression Results – Adjusted Model

Table 4.4 Regression Results – Adjusted Model

Variable	Coefficient (B)	t-value	P-value	Result
Constant	5.256	5.491	0.000	Significant
Adjusted Net Income	0.034	7.634	0.000	Significant
Company Size	-0.638	-4.339	0.000	Significant

Model Summary: $R^2 = 0.685$ Adjusted $R^2 = 0.661$ $F = 29.329$ (Sig. = 0.000)*Source: Prepared by the researcher based on SPSS output.***4-4-4: Model Comparison**

Table 4.5 Model Comparison

Model	R^2	Adjusted R^2	F-value	Sig.	Performance
Traditional Model	0.711	0.690	33.270	0.000	Better
Adjusted Model	0.685	0.661	29.329	0.000	Slightly Lower

*Source: Prepared by the researcher.***4-4-5: Multicollinearity Test (VIF)**

Table 4.6 Multicollinearity Test (VIF)

Variable	VIF
Traditional Net Income	1.694
Adjusted Net Income	1.660
Company Size	1.694

Note: All values are below 5 → No multicollinearity problem.*Source: Prepared by the researcher based on SPSS output.*

Chapter Five

The Impact of Inflationary Accounting on Investor Decisions and Stock Valuation

Introduction

Inflationary accounting, or inflation-adjusted or price-level accounting, is one of the important questions of financial reporting and investment analysis. In economies experiencing fluctuating price levels, traditional historical cost accounting often provides only a poor picture of a company's actual income per annum. Inflation distorts financial statements by overstating profits and undervaluing assets, which can cause investors to make decisions based on nominal rather than real values. Inflationary accounting attempts to rectify these distortions by adjusting financial statements to reflect changes in purchasing power, thus giving the stakeholders access to improved and comparable information. This model enriches the transparency of earnings, of valuations of assets, and of capital maintenance that give investors the ability to make better judgments about a company's performance and future profitability. Policy makers and practitioners need to learn how inflation-adjusted accounting (a practice used to consider the implications of accounting for inflation) impacts investor decision and stock valuation. This perspective helps understand how accurate financial information affects market action, risk assessment, and capital allocation particularly in inflation-prone markets. Thus, studying this link has not only brought increased accounting standards to bear on financial markets but helped to make them more efficient and stable. This paper discusses these dimensions through five highly interrelated parts. The material gives a general overview of the concept on the subject of how accounting information impacts investor behavior and market dynamics, drawing on the concepts outlined in this section of the book. The second part covers the influence of ordinary accounting figures on stock values and how these traditional accounting statistics can influence stock values and investors in the case of inflation contexts in relation to the conventional market data. Section 3 focuses on the performance of these stock values via stock valuation and their value based on the inflation-adjusted number and how the financial statements change based on these adjusted values and how these numbers help or hurt investment strategies and mechanisms for pricing. The fourth section presents an overview of the comparison between investor decisions taking into account either

adjusted or traditional data; the Palestinian market is highlighted. The last part, titled the fifth section, gives a look at the implications to market efficiency and policy proposals and highlights its wider impact on transparency, investor confidence and regulatory overhauls in emerging economies.

5-1 Introduction to Investor Behavior and Market Dynamics.

Investor and market behavior and the mechanics of the stock market provide the underpinning theoretical framework for the process of connecting accounting information to investment decisions and stock price movements. Since the original research by Ball and Brown (1968) which established a direct linkage between accounting earnings and market reactions, more researchers have engaged with how investors read and respond to financial information when forming expectations of company performance in the future. The literature is clear that the significance and trustworthiness of accounting information strongly influence the timing and size of purchase and sell decisions, and thus the short-run price volatility as well as the long-run valuation behavior (Ball & Brown, 1968).

From classical financial theory perspective, EMH (Efficient Market Hypothesis) posits that stock prices incorporate nearly all available information in real time including accounting and it has been a methodical argument by Fama (1970). Within this context, accounting disclosures help enhance price accuracy by adjusting investor expectations in real time. Nevertheless there is empirical evidence that consistently deviates from rigorous efficiency, leading to behavioural explanations for market anomalies like price bubbles, overreactions and momentum effects.

Behavioral finance provides an additional psychological and cognitive dimension to traditional models of investment. Investors tend to follow mental shortcuts (heuristics), experience loss aversion, meaning that they fear falling behind more than they prefer a similar gain, and follow herd behavior, which means that they tend to follow others' investment decisions to the letter under their own uncertainty (Kahneman & Tversky, 1979). And these biases inform much of why prices occasionally diverge from intrinsic price, and why even the same accounting information might elicit different market reactions in different contexts, at different times, and with different market sentiments (Barberis, Shleifer, & Vishny, 1998).

From the point of view of accounting information, not all financial data are equally scrutinized by investors. Research shows that the degree to which earnings are seen as reliable and predictive is critical in determining their impact on stock valuation—earnings believed to reflect real operating performance tend to weigh more heavily than those that are considered transient or simply accounting-based adjustments or are therefore of little value (Lev, 1989). In an inflationary economy, the distinction between historical cost and inflation-adjusted amounts becomes all the more important. This shapes investor interpretations for profitability, asset value and capital maintenance.

The market dynamics complicate matters yet more. Information asymmetry among investors, different transaction costs, and limits to arbitrage all have an impact on how much accounting data gets captured within prices, and quickly. Analysts, institutional investors, and regulators act as intermediaries in the informational space and support investor confidence. Thus, transparency and quality of disclosure become crucial to mitigating behavioral distortions and to market efficiency (Shefrin, 2002; Shiller, 2000).

Finally, market and investor behavior can only be comprehended in the context of classical efficiency theory and behavioral insight, as well as accounting information. The theoretical basis sets the ground for analyses of stock valuation and investment decisions through traditional versus inflation-adjusted accounting ratios, a point which the discussion proceeds to delve deeper into, including consideration of emerging economies like Palestine.

5-2 Theoretical background on how accounting information influences investor decisions.

In light of its relation to the analysis surrounding investor behaviour and the market, as we have seen, we conclude that accounting information serves as a key means through which firms signal economic reality to investors and that the type, content, and perceived quality of the information then influence investor expectations, risk assessments, and the decisions of firms to invest. At the theoretical level, there are four complementary strands explaining how accounting information influences investors' decisions: (1) market efficiency and value relevance; (2) information asymmetry and signalling; (3) agency problems and monitoring; and (4) behavioural adjustment of accounting signals. Each strand emphasizes the different ways in which reported numbers affect prices and portfolio decisions. First, following the Efficient Market Hypothesis (EMH) and value-

relevance literature, accounting disclosures afford the market new information that is reflected in their respective security prices (as reflected in value-relevance estimates). Early empirical work demonstrated a link between accounting earnings and associated disclosures and contemporaneous stock returns such that reported numbers are likely to update investors' belief in firm profitability or cash-flow prospects (Ball & Brown, 1968; Fama, 1970). For it, when accounting information is timely and accurate, forecast risk and price discovery are decreased: the more informative the accounting signal (statistically, the better it signals), the more immediate the effect on valuation models and expected returns. Second, the information-asymmetry and signalling literature sees accounting reports as signals from managers to outside investors, who would have inferior private information (Healy & Palepu, 2001). When insiders have opportunities to manipulate the timing or composition of disclosures, reported figures are informative signals but also sources of noise. The lack of transparency will create information asymmetries and frictions between the company and investors (which can be alleviated with high-quality, transparent accounting), whilst any opaque or aggressively managed reports create uncertainty, increasing required returns and possibly depressing market valuation. Credibility of the signal relies on institutional safeguards — audit quality, enforcement and legal protection — that affects how investors consider accounting evidence at the heart of their rules of decision. Third, we can look at accounting information from the agency theory perspective, where management behaviour is monitored and incentives are aligned. In external governance (creditor covenants, shareholder activism), financial reports are used for measurement, whereas in contracting (compensation, covenants) they provide metrics. Reliable accounting decreases agency costs by allowing investors to understand whether managers are optimally deploying resources; poor or manipulable accounting reinforces moral hazard and can also compel riskier premia to investors or the use of governance-sensitive investment vehicles (Watts & Zimmerman, 1986). Therefore, the impression of governance and of accounting information quality have a material influence on asset allocation. Fourth, behavioural finance takes the above approaches further by acknowledging that investors do not always evaluate accounting information logically. Cognitive biases (e.g., overconfidence, anchoring), heuristics and emotional reactions underlie participants' interpretation of earnings surprises, forecasts and restatements (Kahneman & Tversky, 1979; Barberis, Shleifer, & Vishny, 1998). So investors might have a bias towards overreaction to headline earnings surprises and underweight in response to persistent cash-flow signals

to a significant extent, leading to predictable return results that are distinctively different from textbook price adjustments. Those inherent to accounting characteristics, e.g., accrual versus cash components, transitory adjustments, or one-off transactions, together with behavioural tendencies, act to determine magnitude and duration of price changes (Dechow, Ge, & Schrand, 2010). Operationally, the theoretical mechanisms converge by a few specific channels of accountancy information that directly impact decision-making: (a) valuation inputs — earnings, book value and cash flow metrics are entered directly into discounted cash-flow and multiples-based valuation models; (b) risk assessment — accounting volatility and evidence of earnings quality shape investor estimates of idiosyncratic and systemic risk; (c) expectations formation — trends and revisions in accounting series shape forecasts of future performance; and (d) confidence and liquidity — increased transparency tends to boost investors' confidence and market liquidity, reducing transaction costs and the cost of capital (Penman, 2001; Healy & Palepu, 2001). Yet another key point — which is especially relevant because this chapter is primarily about inflationary accounting — is that measurement bases and price-level adjustments modify each of these channels. If reported numbers exist at historical cost whilst the economy experiences meaningful inflation, this implies investors have to “just adjust” numbers informally (or discount their usefulness), adding to estimation noise and also increasing information asymmetry. Conversely, when reporting inflation levels is more formally adjusted, comparability appears as real and predictive power is restored, but only if investors trust these adjusted numbers and see the consequences for real cash flows and capital maintenance. Accordingly, theoretical background predicts that adoption, quality, and understanding of inflation-adjusted accounting will significantly change valuation outcomes and investor behaviour, an argument explored empirically in the following sections.

5-3 Comparative Perspective: Foreign, Arab, and Palestinian Contexts

Adding to the above-discussed theoretical perspectives, the actual effect of accounting information on investor decisions in practice is quite diverse according to various economic and institutional situations. Even if the developed economies, particularly the US and UK, have well-developed market infrastructures and generally high disclosure quality, some of these Arab and developing markets including Palestine are less developed and

present lower levels of enforcement, less transparency and macroeconomic instability. These differences in the context greatly determine the extent to which investors interpret and trust accounting data when they make investment decisions. As we know from established markets, a proven pattern of regulatory control and standardized reporting, independent audit and capital markets, in developed markets has led to an atmosphere that enables reliable disclosure and decision making around accounting. It has been strongly confirmed that earnings, cash flow, and fair value reports are directly reflected in the stock price, as established by empirical studies; reinforcing the semi-strong form of the Efficient Market Hypothesis (Beaver, 1989; Francis, LaFond, Olsson, & Schipper, 2004). In addition, inflation-adjusted accounting – while primarily historical in the West, is introduced on a periodic basis to maintain comparability and to ensure the reporting of real values, typically in periods of high inflation. As an example, in the late 1970s and early 1980s, the UK and US initiated price-level accounting experiments to improve the informational content of financial reports (Whittington, 1983). Investors in these markets tend to be more analytical and have access to broader information on the market, allowing them to make adjustments for inflation when accounting systems do not yield this data officially. Arab countries in contrast have been found in general to have a mixed reputation for adopting accounting information into investor decision-making. Most of the countries have embraced International Financial Reporting Standards (IFRS) which has made the disclosure comparability better but local adopters are affected due to institutional weaknesses, they may be the lack of good enforcement, political risk, or lack of investor learning (Al-Shammari, Brown, & Tarca, 2008). The empirical evidence from Egypt, Jordan and Saudi Arabia is clear – that investors depend on accounting information yet perceive this information through a lens that is affected by external economic instability and information asymmetries (Abd-Elsalam & Weetman, 2003). In unusually inflated or resource-dependent nations, nominal figures can be deceptive without the correction of inflation differences. For example, as previously mentioned, investors in Egypt and Sudan have struggled to understand the historical costs under uncertain price levels, resulting in

more uncertain stock prices and even higher exposure to the financial markets. Palestine has had a special case within this regional backdrop. The Palestinian economy is also very small, liquidity weak and has a fairly high level of macroeconomic uncertainty induced by political and fiscal factors. Due to the absence of a stable monetary system and numerous intermingling currencies (USD, ILS and JOD), the integration of IFRS by the Palestine Exchange (PEX) and the Palestinian Capital Market Authority (PCMA) has seen little success by international organizations in the application of inflation-adjusted or fair-value accounting practices (Palestine Capital Market Authority, 2020). As a result, investors frequently rely on nominal financial numbers reported in historical terms, which can distort real profitability and asset valuation during inflationary episodes. On the other hand, although in developed economies investors tend to respond well to accounting announcements in terms of accurate disclosures with nuanced valuation models, and in some Arab markets, investors use official and unofficial signals together, Palestinian investors more closely follow only raw financials and reputation-related data (Abu-Nassar & Rutherford, 1996). There is limited access to analytical tools and a culture of cautious investments that is shaped by structural uncertainty, which means the dependence. As a result, the explanatory function of accounting on Palestine's information-dispositionism in this area is partial—at best it is just a kind of reference rather than an important factor in the decision-making for where to invest. In Palestine and other economies with inflationary effects, even where the former may be modest, they have a more adverse impact, because of the nature of imported price volatility and exchange-rate dependence. Missing inflation-adjusted reporting aggravates valuation errors, undermining investor confidence (especially for foreign and institutional investors looking to accurately measure real performance and increases valuation misalignments). Such implementation of locally adapted inflation-adjusted accounting principles, taking inspiration from international experiences but reflecting regional characteristics could help with transparency and market efficiency. In conclusion, the level of information on accounting in shaping investor decision-making is positively related to the maturity of banks, institutions and measures to supervise them

and the level of inflation accounting. While developed countries show high levels of information efficiency, Arab economies show slow momentum with limited institutional support and Palestine is hindered by structural constraints on the effectiveness of accounting information on rational stock-exchangers. The above comparison points out that accounting systems must undergo contextual adaptation — particularly in inflation-related circumstances — for the purpose of being truly effective in the pursuit of fair-valued or informed decision-making. Having previously analysed theoretical and comparative aspects, it is the researcher's opinion that accounting information, particularly when adjusted for inflation, is very essential for investor confidence, valuation accuracy, and the efficiency of the market. But the extent of this influence rests heavily on the economic and institutional context. Strong disclosure frameworks, robust enforcement mechanisms, and sophisticated investor behavior contribute in developed markets to consistency in accounting—be it inflation-adjusted or not—to enable informed decision-making and stock valuation. On the other hand, with many Arab economies, this may not be so, and the experience of Palestine shows that, although accounting statements offer some value, their informational value is still constrained by structural and institutional constraints. Poor regulatory enforcement, weak market liquidity, and lack of comprehensive inflation adjustment data all reduce financial information's value as a guide to investment. For the Palestinian case, and others, the joint coexistence of currencies and the reliance on historical cost accounting causes the assessment of real profitability and asset value to become biased. As such, investors are too often relying on non-financial clues – which might involve reputation, political stability and sectoral expectations – rather than hard and fast accounting signs. He believes that the inclusion of context specific inflationary accounting methodologies in combination with international standards would be valuable tool in the decision-making of financial information provision of Palestine. This reform would address transparency and information asymmetry and encourage not just domestic but also external investors to more actively part in the capital market. Additionally, the inclusion of inflation-adjusted disclosures in financial reporting may act as a buffer in times of economic

turbulence, increasing investor confidence and enabling durable expansion of capital markets. Finally, author suggests: While accounting information affects investor behavior, its impact is moderated by the quality of the reporting, the strength of the institutions, and the willingness to present genuine economic indicators. Transitioning from nominal to inflation-adjusted accounting is not only a technical upgrade for Palestine but also a strategic obligation to enhance its market credibility and make sure economic reality has been captured in financial statements.

5-4 Effect of Traditional Numbers on Stock Valuation

Traditional (historical-cost) accounting numbers serve as the default inputs for most models of valuation and investor heuristics. But when price levels vary substantially, those historical numbers can distort the state of a firm's economy — creating misleading signals that affect markets. The impact of the traditional numbers on stock valuation works via multiple interacting channels: measurement bias, quality and persistence of earnings, valuation multiples and ratios, risk judgement and cost of capital, and market microstructure limitations that preclude corrective arbitrage. First, measurement distortion is the most direct channel. Historical cost accounting documents assets and costs at past-value financial amounts, so in an inflationary scenario, the carrying amounts of long-lived assets and inventories commonly understate their current replacement cost, while depreciation and cost of sales may not reflect actual economic consumption (Whittington, 1983; Penman, 2001). Understating asset bases increases its rates of return (such as return on assets, ROA) and may make investors who rely on balance-sheet statistics overestimate profit and capital efficiency. And because it captures actual historical costs, and if the return due to those costs is nominal — that is, inflationary — then net profit reported can overstate firms' ability to generate real cash flows, in turn, misleading discounted cash flow (DCF) forecasts (Penman, 2001). Second, the quality of earnings and persistence are impacted. Earnings are considered valuable only when they are seen to be expected to persist and have the ability to predict future cash flows (Lev, 1989). The historical-cost earnings that contain inflation-driven non-economic variables (e.g., nominal revaluation gains or losses hidden by cost accounting) diminish the signal-to-noise ratio of earnings series (and thus, predictive power), lowering their predictive value. Lower earning quality introduces uncertainty about future profits which investors make up for by asking for higher levels of expected

returns or by discounting valuation multiples (Dechow et al., 2010). Third, the valuation multiple, as well as financial ratios— price-to-earnings (P/E), price-to-book (P/B), enterprise value/EBITDA— are affected by the accounting measurement base. P/B ratios can falsely be high if book value is understated by historical cost because the market is over-optimistic. In addition, inventory accounting (LIFO versus FIFO) assumptions and cost flow accounting assumptions interact with inflation to generate differing profitability estimates among firms that in practice are essentially similar, undermining the ability to compare firms and determine peer-based relative value (Penman, 2001; Whittington, 1983). And investors who use multiples without price level compensation may misprice firms, a practice that can be systematic in industries exposed to inflation. Fourth, conventional numbers influence risk assessment and the cost of capital. When accounting reporting hides earnings and capital requirements from the real risk of downside, investors become more downside risk-driven/uncertain, in addition to raising equity risk premia (Francis et al., 2004). In effect, information asymmetry and agency costs are exacerbated by the opacity and misinformation of accounting, as investors discount such frictions into required returns (Healy & Palepu, 2001; Watts & Zimmerman, 1986). The net implication would be that firms displaying such distorted-looking financial statements might experience a higher cost of equity and debt, limiting both investment and growth. Fifth, the market microstructure and limits on arbitrage magnify valuation distortions arising from traditional numbers in less liquid or emerging markets. The inability of arbitrageurs to fully correct mispricing is compounded by low liquidity, elevated transaction costs, and regulatory or institutional barriers, even in instances where some investors identify measurement problems and propose remedies (Shleifer & Vishny, 1997; Barberis, Shleifer, & Vishny, 1998). Accordingly, misvaluation from dependence on historical numbers can take place—the predictable return on investment becomes a model of profit where returns can be consistently reflected— rewarding and compensating for the proper adjustment of financials to the level of price and punishing the uninformed investor. In practice these theoretical pathways get translated into the reality of the market. This is evident in empirical evidence that earnings and book values are less informative when accounting does not reflect economic reality and investors either mark their financial statements down or focus on cash flows and non-accounting signals (Lev, 1989; Dechow et al., 2010). Investors can, in inflationary conditions, make informal adjustments (e.g., by indexing previous costs, restating depreciation), but inconsistently applied ad-hoc

approaches yield a variety of valuations amongst market participants, adding volatility and making comparability difficult. Importantly, the institutional setting is important. In these mature markets with strong regulatory standards, extensive analyst coverage, and mature investor markets in their system, these financial actors are more able to identify and correct for the shortfalls of historical-cost numbers, and consequently, the valuation error-prone (Francis et al., 2004). Nevertheless, in emerging or small markets (the Palestinian market from above), the interplay among low liquidity, analyst deficiency, currency complexity and less robust enforcement augments the adverse effects of conventional accounting. In the case of a price-level adjustment being not adopted or done properly, investment decisions can be materially distorted, investment by both foreign, public firms and other investors discouraged and domestic firms' cost of capital rise. In other words, traditional figures, though essential to the systems of accounting, may distort the value of the equity when it is not based on current price levels. The misrepresentation influences fundamental valuation inputs, reduces earnings quality, influences multiples, amplifies risk perception and leads to persistent mispricing whenever there are market frictions. The clear implication is that in inflation-sensitive economies, formal reporting on how to inform policy are either inflation adjustments is required to return financial statements to any decision-usefulness when using inflation-exposed economies and guide investors toward more accurate pricing of stocks. The rational policy implication of these observations is that in an inflation-exposed monetary system, formal inflation-adjusted or a framework of investor guidance with standardisation on the adjustment measures in place must be provided to get back the decision-use of financial statements and to make the stock price more comparable and more reasonably priced.

5-5 Analysis of how conventional accounting figures shape investor perceptions in inflationary environments.

When viewed in this light as an implicit derivative to theoretical background, the normal (historical cost) accounting numbers applied in an inflationary environment progressively modify investors perception through a series of connected information and behavior channels. The basic idea is quite simple: When reported figures don't reflect current purchasing power, they change the way investors consider profitability, asset strength, downside protection and management performance. The next part of this essay

unpacks these effects into concrete mechanisms and illustrates how each is translated into tangible changes in valuation and investor decision-making.

Analysis of measurement bias and apparent profitability. Due to historical-cost accounting, a wide range of longer-lived assets and inventories remain expressed using amounts that reflect historical price movement at all expenses, rather than the current replacement cost. The immediate result is the fact that the accounting rates of return calculated based on the understating of asset bases appear to be artificially high. For instance, suppose for an organization the reported net revenue is 120 and total assets at historical cost equals 600. This returns the historical cost return on assets (ROA):

A. $ROA_{\text{historical}} = \text{Net income} / \text{Historical assets} = 120 / 600 = 0.2 = 20\%$.
(Check: $600 \times 0.2 = 120$.)

B. If inflation has driven up replacement costs up to the point where a sensible asset base is 900, the inflation-adjusted ROA is:

C. $ROA_{\text{adjusted}} = \text{Net income} / \text{Replacement assets} = 120 / 900 = 0.133333... \approx 13.33\%$. (Check: $900 \times 0.133333... = 120$.)

This means that investors who use historical data for analysis will expect a 20% ROA and conclude that the firm is highly efficient, as opposed to the investor who is treating price-level fluctuations and will read a materially lower profitability of about 13.33%. It has an immediate impact on the perceived growth potential, perceived managerial performance, and inputs to valuation models (Penman, 2001; Whittington, 1983).

Distorted balance sheet metrics and relative valuations. Understated book values inflate standard market multiples. Take this numerical example: market price (or market capitalization per share equivalent) = 1,000 and in the case where book value per basis is reported as 500 (historical cost). P/B (Price-to-book) ratio for historical cost is:

A. $P/B_{\text{historical}} = \text{Market price} / \text{Book value}_{\text{historical}} = 1000 / 500 = 2.0$.
(Check: $500 \times 2.0 = 1000$.)

B. If a price-level adjustment yields a book value of 800, the adjusted P/B is:

C. $P/B_{\text{adjusted}} = \text{Market price} / \text{Book value}_{\text{adjusted}} = 1000 / 800 = 1.25$. (Check: $800 \times 1.25 = 1000$.)

There is a very different interpretation: A P/B of 2 will seem “strong growth expectations” or overvalued by the market, compared to a P/B of 1.25, where there is a very conservative market view. Multiples that do not take inflation into account cause the investor to systematically price too far, even when the sector is not so heavy (Penman, 2001; Whittington, 1983).

The quality of earnings, transitory items, and persistence considerations. In inflationary environments nominal increases in profit may include major non-material parts (like inventory surplus due to increased replacement costs as measured under some methods). Because investors have an appetite for earnings persistence—the proportion of current-adjusted earnings that forecast out to future cash flows over time—nominal earnings that are a reflection of inflation decrease the predictive power of reported earnings. As a result, market participants might discount earnings persistence and rely more on cash-flow metrics or on accounting numbers deemed to be more “real” by the market (e.g., operating cash flow) (Lev, 1989; Dechow, Ge, & Schrand, 2010). This change significantly affects ROI and valuation estimates and is often unfavorable to firms with asset-intensive profiles.

Information asymmetry, credibility, and risk premia. When accounting is incapable of expressing real economic values, information asymmetry is exacerbated: sophisticated investors or analysts who can manipulate reports gain an information competitive advantage over retail investors or less informed consumers. This asymmetry increases required risk premia for the uninformed and potentially higher cost of capital of a less transparent firm. Also, when managers are perceived as market opportunistic in their timing/position of inflation appreciation, investor trust declines, and this will heighten the risk discounting of the valuations (Healy & Palepu, 2001; Watts & Zimmerman, 1986).

Behavioral reactions and market actions. Behavioral biases interact with deceptive mainstream data. For example, investors can rely on headline earnings or on historical ratios regardless of what is becoming apparent and then they can lead to over or under reaction in prices (Kahneman & Tversky, 1979; Barberis, Shleifer, & Vishny, 1998). These behavioural tendencies are enhanced in illiquid or information-poor markets;

misestimates of nominal figures can last longer, since control of arbitrage limits prevent early correction (Shleifer & Vishny, 1997).

Cross-firm comparison and sectoral misallocation. However, conventional accounting, under inflation, can often be heterogeneous among firms (older capital bases (e.g. the years of investment) vs. more recent investments, or inventory accounting methods). Such heterogeneity diminishes peer comparisons and can also mislead sector rotation planning, resulting in greater investor preference for firms that do but report the best in nominal measures rather than those with superior real prospects for the economy (Penman, 2001).

Pragmatist investor response: constraints on ‘the role of informal restatement’. Investors do not always take a passive approach. Many do informal restatements — indexing past costs, accounting for depreciation, recalibrating book values — to recoup real performance measures. But these ad-hoc approaches are inconsistent across investors, depend on assumptions that are not necessarily shared, and contribute to valuation outcome heterogeneity; the absence of such a generic inflation-adjusted basis for reporting hence reduces market comparability and increases price volatility (Whittington, 1983; Penman, 2001).

Practical and policy implications – on investor perception. Collectively, those channels suggest that orthodox accounting in inflationary conditions biases investors assumptions unless offset by formalized reporting of inflation-adjusted accounting or strong disclosure and education that allow the investors to make steady adjustments. Especially in emerging and small markets where the availability of analyst coverage, enforcement and financial literacy may be limited, these effects are felt acutely. Standardised inflation adjustment, more transparent disclosure on price-level effects, and the implementation of enhanced audit and enforcement instruments would enhance the interpretability of accounting figures, reduce information asymmetry and thereby lead to fair and more accurate market values (Healy & Palepu, 2001; Penman, 2001).

5-6 Comparative Analysis: Developed Countries, Arab Economies, and Palestine

Drawing on the previous analysis, effects of common accounting figures on investor perceptions are shaped by different countries' economic, institutional, and market frameworks. Investors in developed economies like the United States, Germany, and the United Kingdom understand historical-cost accounting, and market mechanisms allow them to informally adjust valuations in the face of inflation or other economic distortions. In fact, when U.S. inflation was high in the late 1970s, investors and analysts regularly revised reported earnings and book values in order to make an estimate of real profitability and capital maintenance (Whittington, 1983). Likewise, in Germany firms frequently supplement historical-cost reports with additional reports or inflation-adjusted disclosures to facilitate investor interpretation (Ball & Brown, 1968). Such schemes decrease the risk that traditional numbers will be misleading for consumers and enable valuation multiples to represent economic performance in more accurate terms.

Arab economies, in contrast, are of mixed success. Countries such as Egypt, Jordan, and Saudi Arabia have largely implemented IFRS-based frameworks to enhance the transparency and comparability of financial statements. Compliance loopholes, market shortfalls and inflation uncertainty make the interpretability of historical-cost figures challenging. During the high inflation wave in Egypt during the late 1980s, investors made extensive use of the historical-cost statements, which made the company's profitability seem overstated because its asset values were kept to a minimum and this inflated price-to-book ratios was used (Abd-Elsalam & Weetman, 2003). In Saudi Arabia, the historical cost accounting practices of firms occasionally obscured the actual impact of the increase in material costs in industries such as petrochemicals resulting in short-run mispricing which also had to be corrected with the investors' perception and not the formal accounting (Al-Shammari, Brown & Tarca, 2008).

In Palestine, the impact is far greater. The Palestinian market is small and complex with low liquidity and analyst availability. Historical cost accounting reigns supreme, and the inflationary or currency fluctuations which are compounded with many

circulating currencies (ILS, USD, JOD) do more damage to investor perception (Palestine Capital Market Authority, 2020). For instance, a construction business that reports historical-cost asset values while local inflation is running high may seem to make more money than it does in real terms. Investors who do not have formal inflation-adjusted data have to use informal estimates or a sense of comparability, which can lead to mispricing and an inflated perception of risk. Differently from the developed markets where analytic tools and supplementary reports reduce distortions, Palestinian investors in comparison, suffer from greater uncertainty and uneven application of valuation adjustments resulting in less market efficiency and significantly more reliance on non-financial signals (i.e., firm reputation and political risk assessment) (Abu-Nassar & Rutherford, 1996).

The comparison points to two major contrasts in investment perception, with investor sophistication and supplementary reporting aiding in mitigating distortion in developed economies, whereas structural and regulatory barriers in Arab economies further exacerbate distortion; in developed markets, and institutional weaknesses, market limitations, and fluctuations in the currency rate in Palestine make it particularly difficult to interpret historical cost figures for investors. Thus, in Palestine, over-reliance on traditional numbers without variations may cause massive inaccuracies and discourage both domestic and foreign investment.

The paper argues that traditional accounting principles while crucial for standardizing accounting, may mislead investors in inflationary times. This distortion is reduced in developed markets, where capitalised investors and additional reporting practice minimize the influence and stock levels and prices. With enforcement gaps, market illiquidity and inflation volatility causing partial distortions in many Arab countries such that investors are more hesitant to adjust their perception. The effect is even more apparent in Palestine. Such market power, liquidity scarcity, limited analyst coverage, and multiple national currencies combine to create the conditions for historical-cost figures to be misinterpreted. Investors tend to base decisions primarily on nominal numbers — or nonfinancial signals — which creates a higher degree of uncertainty and risks mispricing.

The scholar concludes therefore that introducing inflation-adjusted accounting or providing guidance in how to interpret historical-cost figures would dramatically increase transparency, increase investor confidence and support more accurate stock pricing in emerging and inflation-exposed markets such as Palestine.

5-7 Effect of Inflation-Adjusted Numbers on Stock Valuation

Inflation-adjusted accounting generates financials that more accurately represent the economic situation of firms in eras of higher general price levels. The former accounts for past-cash amounts of assets, liabilities, and expenses compared with historical-cost figures, but as inflation-adjusted figures adjust these numbers to reflect their present purchasing power, investors obtain information of greater value for valuation and decision making (Whittington, 1983; Penman, 2001).

A. Improved measurement of actual profitability. Inflation-adjusted accounting helps account for the real return on assets in net income and asset values, instead of nominal growth in inflation-driven net income. It is thus easier for the investor to determine more realistic profitability ratios (ROA and ROE) by re-estimating the life of assets and stock to current levels, providing better forecast of future cash flows (Lev, 1989; Penman, 2001).

B. Enhanced comparability and valuation multiples. Inflation-adjusted numbers are better for cross-firm and intertemporal comparison because the financial statements are shown in present purchasing power terms. Valuation multiples, including price-to-book (P/B) or price-to-earnings (P/E), become more relevant as both the numerator (in the market price) and the denominator (book value or earnings) convey comparable underlying economic values (Whittington, 1983; Dechow, Ge, & Schrand, 2010). A historical-cost P/B ratio, for example, may exaggerate market optimism in inflation, whereas its inflation-adjusted P/B ratio yields a more accurate estimate of firm value.

C. Improved risk and capitalization assessment. Inflation-adjusted reporting enables investors to analyze a company's solvency and equity buffer more fairly. Underestimation of asset values over historical-cost may inflate the expected level of risk

and necessary cost of capital. Adjusted figures show real replacement costs that allow investors to better understand whether the firm can continue to pay dividends, service debt, or sustain a business during economic downturns (Francis, LaFond, Olsson, & Schipper, 2004).

D. Effects on the decisions made by investors. Data adjusted for inflation helps investors make informed and rational decisions. Correcting historical distortions has two effects: A, it reduces the information asymmetry and aids with stock pricing; therefore the market can be made more stable and a more efficient capital allocation can take place. In asset-heavy sectors like manufacturing or construction, the inflation-adjusted figures help prevent the overestimation of growth potential and profitability (Penman, 2001; Healy & Palepu, 2001).

E. Behavior biases mitigated. Historical-cost statements are often based on nominal figures that may have biases, for example, by anchoring to reported earnings. Empirical data regarding inflation-adjusted numbers reduces such biases through reporting profits and asset values by matching them with prevailing economic conditions, so that the stated firm profits and securities and/or assets return the most stable and correct estimates of market value (Kahneman & Tversky, 1979; Shleifer & Vishny, 1997).

F. For implementation in growing countries and Palestine. Even in developing countries where there are more significant inflation and a lot of currency depreciation, limited maturity in the market, for example in the Middle East (Palestine), reporting an inflation-adjusted measure increases investor confidence (Palestine Capital Market Authority, 2020; Abu-Nassar & Rutherford, 1996) and, as a whole, will reduce mispricing. So inflation-adjusted accounting makes the results of financial statements more reliable, visible, and useful for decision-making. By correcting distortions inherent in the historical-cost reporting, it enables investors to more accurately gauge profitability and risk, firm value and company value, which lead to better investment decisions from them; as a consequence, a much more efficient capital market has also been achieved.

5-8 Examination of how adjusted data alter investment strategies and stock pricing.

Inflation-adjusted accounting provides accounting that better reflects the real performance of firms by recalibrating historical-cost figures to current purchasing power. This adjustment affects the investment strategies and stock prices directly by giving investors dependable measures of profitability, risk, and asset value.

Effect on investing strategy formulation. We have accounting data that investors use to analyze a firm's performance, growth potential, and stability. Due to historical-cost accounting in inflationary economies, it is prone to excessive profitability and understated asset bases, which can then cause investors to adopt overly aggressive strategies overvaluation using nominal earnings. On the other hand, adjusted data reflect the actual economic returns and the replacement cost of assets, so investors can recalibrate their expectations. Firms, for example, that seemed very profitable according to historical-cost reporting may end up showing somewhat lower returns when adjusted for inflation, motivating investors to diversify or reduce their exposure to overvalued sectors (Penman, 2001; Whittington, 1983). More importantly, inflation-adjusted data aid investors to assess their real risk and capital adequacy and consequently can help inform the more judicious allocation of capital in the different sectors. The industries that are asset-heavy, like manufacturing or infrastructure, are especially sensitive: adjusted numbers reflect that a larger share of profits can be absorbed by replacement costs, which can affect the decision on dividends reinvestment, leverage, and when to enter or exit the market (Francis, LaFond, Olsson, & Schipper, 2004).

Effect on stock price and market valuation. Stock prices are based on investors' forecast of future cash flows and their associated risks. Inflation-adjusted accounting supplies a more accurate basis for forecasting these cash flows if it measures assets and liabilities' true economic value. To give an example, it appears that, when book values are adjusted for inflation, the price-to-book ratio (P/B) becomes a more accurate representation of market prices. While the historical-cost P/B may be significantly higher in case stock was overvalued, an adjusted P/B is a realistic measure of value and

can lead investors not to overpay for shares (Lev, 1989; Dechow, Ge, & Schrand, 2010). In addition, modified earnings information mitigates information asymmetry and behavioral biases. In turn, nominal earnings increases due to inflation tend to cause a response from investors that minimizes stock price volatility (Kahneman & Tversky, 1979; Shleifer & Vishny, 1997). Such stabilization helps boost investor confidence and tends to lower risk premia which leads to lower cost of capital and longer-term investment strategies.

Implications for sectors and markets. Improved data also allow improved sectoral comparative analysis and cross-market analysis. Different sectors of firms may see different degrees of asset cost inflation in high inflation markets. Because firms are reported adjusted for inflation, investors can pinpoint genuinely profitable firms that are truly profitable, unlike those that are receiving nominal growth and thus can profit more. In Palestine, an example is construction and import-oriented sectors being affected by price-level changes so adjusted accounting data will allow investors to make valid investment decisions and not misallocate funds (Palestine Capital Market Authority, 2020; Abu-Nassar & Rutherford, 1996).

Long-term strategic implications for investors. Inflation-adjusted accounting helps investors to make portfolio and asset management, exposure risk, and capital budgeting decisions in terms of profitability and capital adequacy by giving them a pragmatic estimate of the industry. As a result, market participants are able to make decisions about dividend payout, asset ownership, and leverage that reflect actual economic activity that are not artifacts of nominal accounting. This leads to more efficient capital markets, improved pricing mechanisms, and more trust among investors over time (Healy & Palepu, 2001; Penman, 2001). If inflation-adjusted financial data is implemented correctly, it can significantly make the approach to investments and the price of stocks, create a more accurate understanding of the performance of companies, and diminish the influence of misperception and behavioral biases, as well as guide managers to allocate resources in an evidence-informed manner. Inflation-exposed and emerging markets are particularly susceptible as investors tend to make rational decisions, can balance risk and obtain superior portfolio returns.

5-9 Comparative Impact of Inflation-Adjusted Numbers on Investment Strategies and Stock Pricing

Drawing from the theoretical and the practical discussion of inflation-adjusted accounting, the effect of such data varies by market according to levels of economic security, investor savviness, and institutional arrangements. Developed Countries. Investors in advanced markets, such as the U.S., Germany and UK, now have a wealth of sophisticated financial analysis tools, models and other disclosures that incorporate inflation-adjusted information into investment decisions. In the late 1970s, during periods of high inflation in the U.S., for instance, analysts regularly adjusted earnings, asset value and depreciation using price-level fluctuations to arrive at accurate valuations (Whittington, 1983). Such adjustments enabled investors to better balance portfolios, avoid overpaying for equities, and optimize cash forecasting. In Germany, supplemental reports accompanying historical-cost statements included inflation-adjusted information. This made cross-period comparison possible and, especially in capital intensive types of enterprise, directed investment strategies (Ball & Brown, 1968). Thus overall, inflation-adjusted accounting reduces uncertainty and improves the efficiency of pricing; therefore, the investor can take better risk-sensitive and informed decisions. Arab Economies. The implementation of IFRS frameworks has enhanced comparability and transparency of financial reporting in Arab nations like Egypt, Saudi Arabia, and Jordan. But the flexible implementation of adjusted accounting data is limited by enforcement gaps, market illiquidity, and high inflation volatility. During the 1980s and early 2000s in Egypt, many investors relying solely on historical-cost statement analysis had a bad estimation of firms' profitability: for instance in manufacturing production and the industrial sector they misstated earnings by not accounting for inflation rates (Abd-Elsalam & Weetman, 2003). In general, where inflation-adjusted figures did exist they gave investors a way to adjust market valuations and investment strategies. However, the sporadic use of such data and patchy reporting

standards limited its influence over market-wide decision-making. Likewise, in Saudi Arabia, occasionally firms supplied supplementary inflation-adjusted disclosures for capital intensive projects, which allowed to determine timing their investment decisions and assessment of investment risk. The usage of stock value adjusted for inflation was hampered by uneven reporting standards. Palestine. The impact of inflation-adjusted data on investment strategies and stock pricing is particularly notable in Palestine, where the market is small, fragmented and characterized by low liquidity and relatively limited analyst coverage. Investors face numerous currencies (ILS, USD, JOD) and significant inflationary pressures that produce distortions in nominal figures. Investors use the adjusted data to assess the actual economic performance of firms, e.g. construction companies or import-dependent businesses, which show real profitability and therefore capital adequacy (Palestine Capital Market Authority, 2020; Abu-Nassar & Rutherford, 1996); and it supports assessment of real performance by investors. Inflation-adjusted accounting gives investors easier access to risk information, which can help to adjust for potential riskiness in equities or valuation, adjust market price, and fine-tune such portfolio strategies as timing of entry or exit, diversification and allocation to sectors. Nonetheless, inclusion of inflation-adjusted accounts for these issues in Palestine practice is still limited and most markets still fall back on informal and nonfinancial signaling. To an extent it adds a level of uncertainty and reduces efficiency. What Have We Learned Across the Literature? A. There is a gradation in these analysis results. In developed markets, inflation-adjusted economic data are relatively well used to implement investment strategies and stock value and pricing in the market, thanks to market sophistication and regulation. B. In Arab economies where updated data are available, investing decisions improve but weak enforcement and inconsistent reporting constraints reduce their overall effectiveness. C. With regard to Palestine, using an adjusted data system can significantly enhance investor sentiment and market prices, however accessibility and institutional issues prevent it. Taken together, and with the benefit given by inflation adjusted accounting to stock prices the most consistent with the prevailing stock price, rational investment choices can

be arrived at, but the role of the inflation adjusted accounting is highly dependent on both the level of market developments at the time, on regulatory standards and on investor complexity. To these researchers inflation-adjusted accounting provides a much improved stock valuation value and rationalised investment. In developed markets, investors are also using adjusted data to properly align stock price and economic reality, mitigate risk, and optimize portfolios. In many Arab economies, adjusted data helps make better decisions but uneven reporting and enforcement gaps limit their effectiveness. In Palestine, they contend that inflation-adjusted accounting is a transformation mechanism. Considering the small size of the market, low liquidity, trading on several currencies and inflationary pressures, accurate, adjusted financial status data would be crucial in helping investors gauge their prospects better, and in so doing make decisions on profitability, capital adequacy, and risk, leading to smarter investment policy decisions and fairer stock pricing. But it is currently under-represented owing to low levels of adoption and institutional limitations, and thus has limited power, and regulatory oversight and wider adoption is sought.

5-10 Comparative Impact on Investor Decision-Making

Investor decisions are highly dependent on the accuracy, applicability, and explainability of financial data. The accounting figures, whether reported at historical cost, or adjusted for inflation, are the basic metrics that investors use to gauge profitability, assess risk, and evaluate the value of a firm. Because of differences in market maturity, regulatory enforcement, and investor sophistication (Penman, 2001; Whittington, 1983), the comparison among these figures is relatively different between developed markets, Arab economies, and Palestine. In developed markets, investors generally are more financially literate, and have the best analytical tools available. Inflation-adjusted accounting — when used as supplemental disclosures or used in valuation models — allows investors to make decisions based on reasonable assessments of their profitability and capital adequacy, rather than on nominal historical-cost figures that are subject to inflation. When

prices surged in the U.S. in the late 1970s, for instance, analysts routinely adjusted reported earnings and asset values to be more in line with actual economic performance, helping make more sophisticated portfolio investment and price decision-making (Lev, 1989; Whittington, 1983). In Germany, these additional inflation-adjusted disclosures had allowed investors to compare across periods and to determine true profitability, especially in capital-intensive sectors, which, in the end, paved the way for more rational decision-making (Ball & Brown, 1968).

Investors in Arab economies like Egypt, Jordan, and Saudi Arabia take the decision to invest not only because they have good access to accounting information, but also due to enforcement and market structure. International Financial Reporting Standards (IFRS) have enhanced transparency and comparability, but gaps in enforcement and illiquidity in the market have limited the practical effectiveness of accounting information. If investors only rely on historical-cost statements during periods of inflation, they might overestimate profitability, or misinterpret risk, promoting suboptimal investment strategies (Abd-Elsalam & Weetman, 2003; Al-Shammari, Brown, & Tarca, 2008). When inflation-adjusted information is available, investors can re-arrange portfolio, reflect more accurately on stock valuations, and modify timing of investment decisions, but the heterogeneity of reporting among firms limits the effect on the market. In Palestine, accounting information tends to have a more general comparative impact on investor decision-making owing to the small and fragmented market, low liquidity levels, and analyst underrepresentation in this economy. The investors must contend with two or more currencies and relevant inflationary episodes which can seriously distort the historical-cost financial statements (Palestine Capital Market Authority, 2020). The possibility to access inflation-adjusted accounting information will be of great assistance to investors in their assessment of the true profitability, the adequacy of their capital or the risk they face. That enables better decision making when to invest in and out of stocks, consider diversifying their portfolio, or when to be exposed to stocks or to exit markets. However, restricted adoption of adjusted reporting and institutional constraints

prevent many investors from having informal adjustments or following other financial cues which contributes to uncertainty and may also play a role in mispricing (Abu-Nassar & Rutherford, 1996). On the whole, the comparative analysis indicates that investor preferences are affected by accounting information in a gradient. Inflation-adjusted and historical-cost data is used extensively and highly in sophisticated investment strategies in developed markets. Arab economies realise moderate benefits, limited by enforcement gaps and market structure constraints. Palestine is promising but has practical difficulties in gaining and using such inflation adjustment information, and needs both regulatory guidance and wider adoption of the reporting approach. In the end, the availability, quality and interpretability of accounting information, especially with respect to inflation information, have a direct impact on the rationality, efficiency and confidence of investors' decision-making in one market relative to another.

5-11 Discussion of investor reliance on either adjusted or traditional information, with emphasis on the Palestinian context.

Accounting information is a central consideration for decision-making and is thus utilized by investors because the financial statements are a primary source of information with which to evaluate firm performance, risk and valuation. When inflation runs high, investors are faced with a question: are we to depend on the historical-cost or inflation-adjusted numbers—both have different implications for analysis and policy (Penman, 2001; Whittington, 1983)?

1. Reliance on Traditional Accounting Information

For most of history, a significant proportion of investors, particularly in the emerging countries, have depended on historical-cost financial statements on account of their availability, acceptance by regulators and ease of use. These statements can be misleading in inflation era as assets and earnings are recorded at historical monetary values and do not match the current purchasing power of the company. With little liquidity and analyst coverage in Palestine's small markets, investors rely often on historical-cost data although it is limited. There is high danger of increasing profitability, overvaluing stocks and resorting to less-than efficient investment strategy, for example in asset-heavy industry such as construction and manufacturing (Abu-Nassar &

Rutherford, 1996; Palestine Capital Market Authority, 2020). 2. Reliance on Inflation-Adjusted Information

Inflation-adjusted accounting reflects assets, liabilities and the actual performance of the firm in current purchasing power terms better than inflation. Those investors that use adjusted information will also receive an enhanced ability to determine if the business is making money (and whether it is profitable or not). Data is adjusted so that replacement costs for assets, proper evaluation of return on investment, and expectations for cash flow can be assessed, to cut down on information asymmetry and behavior prejudice in future decisions (Lev, 1989; Penman, 2001). 3. Palestinian Context and Practical Challenges

In Palestine, the reliance of investors on inflation-adjusted information is still very limited for institutional, regulatory and practical reasons. Many companies tend not to publish inflation-adjusted statements, and investors do not often have access to formal analytical tools or explanation for how to interpret this data. Thus, even though the benefits of revised ratios in addressing mispricing and helping to form better-informed strategies have been apparent, stockholders often augment the historical-cost information with informal revision or qualitative examination (Abd-Elsalam & Weetman, 2003; Palestine Capital Market Authority, 2020). The market's dependence on traditional information is reinforced by existing regulatory practices, limited auditing capacity, and the requirements for prompt reporting. 4. Comparative Commentary and Implications

When looking down the dependent pattern of information: The reliance pattern comparison results show that in developed economies, investors take into account both price-cost and adjusted data so that full analysis of these figures can be carried out; whereas for Arab countries, both historical-cost data and adjusted data are available but not consistently used. Palestine's reliance on traditional accounting information may lead to market failures and incorrect stock evaluations. Greater availability of inflation-adjusted reports, underpinned by regulation and investor education, can greatly increase transparency in the market, increase investor confidence (Whittington, 1983; Penman, 2001), and make investment decisions more rational. Long and short, traditional accounting is still prevalent in Palestine as it's easier to gain access to because of regulatory standards, whereas the inflation-corrected version is more accurate with respect to how valuation and risk have been evaluated. Enhancing the use of adjusted information is essential in fostering investors' ability to trust meaningful financial

information and increasing the efficiency of the Palestinian capital market. Comparing Investor Dependence on Accounting Information

Different types of investors relying on traditional accounting information (or on inflation adjusted accounting information) are more heterogeneous based on market sophistication, data availability, and regulatory frameworks. This study compares developed countries and Palestine and indicates differences in both the level of practical application and findings with regard to the Palestine issue. 1. Developed Countries: Use Adjusted Data

In developed markets like the US, the UK and Germany, investors often rely on historical-cost as well as inflation-adjusted information. For instance, in the years of runaway U.S inflation in the late 1970s, investors turned to inflation-adjusted disclosures from firms to determine real earnings and potential asset replacement costs. This enabled the stock to be valued more accurately with informed portfolio choices to not be overvalued by nominal earnings (Whittington, 1983; Lev, 1989). In Germany, for example, firms in industry usually published adjusted balance sheets for capital-intensive undertakings which allowed investors to compare better among time periods and industries, and which supported rational investment plans and risk assessment (Ball & Brown, 1968). The use and practical examples in Palestine are limited. In Palestine, the adoption of inflation-adjusted reporting is limited and the use of historical-cost financial statements has become common for investors. If, say, a building company does business in Ramallah. While historical-cost statements could account for high nominal profits from material cost inflation for firms, investors would overestimate the firm's real profit without such adjustment. If inflation-adjusted reports are available, even infrequently, investors can recognize that a certain portion of the nominal profit is compensated by higher replacement costs of capital and materials, leading to prudent investment and sound portfolio decision making (Palestine Capital Market Authority, 2020; Abu-Nassar & Rutherford, 1996). Import-heavy businesses in Palestine are another example. Historical-cost reporting could provide inflated figures for revenue on account of currency movements or inflation, leading investors to misperceive the firm's real earning capabilities. Having access to adjusted data enables investors to include real purchasing power and make educated decisions about stock pricing, dividend expectations and market entry timing. Yet with limited reporting of these adjusted reports, investors often employ informal adjustments or do so through relying on nonfinancial indicators and

accordingly higher-risk (i.e., non-financial reporting) signals, which raises the risk of mispricing (Abu-Nassar & Rutherford, 1996). Comparative Insights. A. Investors in developed countries have systems of using adjusted accounting data that are integrated with the latest financial reporting, with well-defined, reliable regulation. This diminishes mispricing, increases market efficiency, and enables real risk measurement. B. In Palestine, traditional historical-cost data prevails owing to limited access to adjusted reports, institutional constraints, and lack of standardization. Investors might misinterpret return and risk perceptions that lead to inefficient stock pricing and suboptimal investment policies. C. These are examples that demonstrate severe information asymmetry and investor dependence, indicating the good that institutionalizing inflation-adjusted reporting can offer to foreign investors in the Middle East like the Palestinians here. If done correctly, such implementation could increase transparency, decision-making, and the efficiency to allocate capital (Penman, 2001; Whittington, 1983). According to this perspective, there is a direct nexus between the quality of investor decision-making and dependence on accounting information, whether of a traditional or inflation-adjusted nature. In the developed world, investors enjoy systematic access to historical-cost and adjusted information and are therefore free to make more intelligent, risk-conscious investments. In Palestine, however, the researcher notices, due to a lack of inflation-adjusted reports and institutional limitations, investors continue to rely on conventional historical-cost statements. Such overreliance can result in unrealistic assumptions about actual profitability, skewed stock prices, and inefficient allocation of funds. The researcher posits that greater implementation of inflation-adjusted accounting, coupled with regulatory enforcement and investor education, will result in greater market transparency and decision-making efficiency in Palestine.

5-12 Implications for Market Efficiency and Policy Recommendations

The deployment of accounting information, whether historical-cost or inflation-adjusted information, has direct effects on market efficiency, investor confidence, and regulatory policy. Market efficiency generally relies on the quality, transparency, and timeliness of financial information accessible to investors. Impaired or incorrect information may cause stock prices to be mispriced, inappropriate investment decisions, and higher price volatility (Penman, 2001; Lev, 1989).

5-12-1 Implications for Market Efficiency

Inflation-adjusted accounting can contribute a great deal to making a market more efficient through realistic measurements of profitability, asset values and financial performance. In developed markets, adjusted financial statements encourage investors to make informed choices, reducing information asymmetry and raising the accuracy level of stock valuations (Whittington, 1983). For instance, in developing and highly inflationary economies like Palestine, an over-reliance on historical cost accounting practices (i.e., conventional historical cost accounting) may distort valuations, create excessive or underestimated valuations, and may impair the efficiency or effectiveness of allocation of capital in firm performance (Abu-Nassar & Rutherford, 1996; Palestine Capital Market Authority, 2020). For instance, in asset-intensive industries such as construction or manufacturing, ignoring inflation can misrepresent real profitability and capital adequacy, which results in inefficient investing practices.

5-12-2 Policy Recommendations for Enhancing Market Efficiency

There are a few policies to be adopted, based on the found difficulties and some of the comparative approaches:

- o Compulsory Inflation-adjusted Financial Reporting: Regulators should mandate companies to prepare more inflation-adjusted financial statements, especially in inflation-affected industries. This also ensures that investors have more accurate information for making decisions (Penman, 2001).
- o Investor education and training: It is recommended that investors be educated on the advantages of using inflation adjusted data and the training of them to interpret such information can increase market rationality and confidence on investment decisions (Abd-Elsalam & Weetman, 2003).
- o Reinforcing Regulatory Oversight: mechanisms have to ensure companies comply with reporting standards for all historical-cost and adjusted financial information, both in addition to being audited regularly and punishable (Al-Shammari et al., 2008).

- o International standard alignment: Aligning the local accounting rules with IFRS and providing for an input of inflation adjusted disclosures provides better comparability, attracts foreign investment and increases total market efficiency (Lev, 1989).

- o Promoting Transparency and Timely Reporting: Organizations need to be encouraged to provide timely and accurate reporting. Transparent financial reporting reduces information asymmetry, improves investor confidence and, in particular, enhances the efficiency of stock markets (Palestine Capital Market Authority, 2020)—especially in small and developing economies like Palestine (Palestine Capital Market Authority, 2020).

Comparative Insights

The experiences of developed economies provide evidence that those markets with an up-to-date, relevant and accurate inflation adjusted information display higher efficiency, a better level of price/market linkage to economic fundamentals, and lower stock market volatility. In other emerging markets, like Palestine, with no systematic adjusted reporting and investor dependence on traditional historical-cost information creates an inefficient system with high information asymmetry. Policy options such as mandatory adjusted reporting, investor education, and enforcement of the rules could fill this gap and potentially restore the soundness of the Palestinian capital market. However, the integration of inflation-adjusted accounting into financial reporting together with correct and realistic policy and regulatory initiatives would benefit the market efficiency, facilitate the investors' confidence and the allocation of capital in developing countries and mature countries.

5-13 Broader implications for transparency, investor confidence, and regulatory practices in emerging markets.

The quality and presentation of accounting information has great implications for the functioning of capital markets, particularly in emerging economies. Transparent accounting reports are critically important in order to reduce information asymmetry between companies and investors. This impacts either investor optimism or even market efficiency (Penman, 2001; Lev, 1989). Clear, valid, and timely disclosure of the financial performance of the company is facilitated due to transparent accounting practices, such

as accurate reporting of historical costs, and accounting adjustments for inflation. Transparency is most difficult to achieve given the weak requirement for disclosure in emerging markets, the conflicting nature of implementing accounting standards, and the dependence on traditional accounting tools that do not take effect to address financial volatility. For instance, from Arab countries, it has been found that businesses of more transparent reporting practices have more trust of investors and have relatively stable stock values, while a lack of clarity results in the trading of securities that are not accurately priced and also volatility of the markets (Abd-Elsalam & Weetman, 2003; Al-Shammari, Brown, & Tarca, 2008).

B. Investor Confidence

Investors want to be confident in the news not just because of the access to it, but that it is reliable. In an environment where inflation-adjusted reporting is very limited, the investors may doubt that the financial statements are correct — which might lead them to either cut their money with caution or even demand greater risk premiums. The small, fragmented capital market size and fragmented reporting and a limited oversight can erode investor confidence in Palestine. On the other hand uniform and accurate inflation-adjusted reporting, as per international practice, would generate trust, stimulate participation and promote a more rational investment approach (Abu-Nassar & Rutherford, 1996; Palestine Capital Market Authority, 2020).

C. Regulatory Practices

In order to ensure transparency and restore investor confidence, regulatory frameworks are an essential element. In the emerging market environment, you may need robust accounting standards enforcement, supplemental inflation-adjusted reporting as well as robust auditing practices in place, and strong compliance. At the same time, the Palestinian Capital Market Authority has put forward instruments which can improve both the standard and frequency of disclosure and audits. Yet there remain questions with limited institutional capacity and market infrastructure. For instance, by

enhancing regulations instructing transparent reporting and especially in inflation complex sectors.

D. Broader Market Implications

Transparency and investor confidence enhance market efficacy and stability and liquidity. Accurate and up-to-date accounting allows investors to take better decisions, decreases mispricing, and makes long-range investors even more attractive. For developing countries such as Palestine, the inclusion of inflation-adjusted accounting and the adoption of robust disclosure systems may lead to more stable capital markets, domestic and foreign investors, and a conducive environment for sustainable economic development (Penman, 2001; Lev, 1989).

More broadly, the implications for emerging markets suggest that transparency, investor confidence and regulatory effectiveness are interrelated. Not only do the improved accounting practices, including reporting adjusted for inflation, further enhance financial clarity, but also contribute to both market stability and intelligent investment of the economy in the long run.

5-14 Comparative Analysis: Transparency, Investor Confidence, and Regulatory Practices

Investor confidence and market efficiency importantly depend on the transparency of financial reporting and the effectiveness of regulatory frameworks. Between advanced and emerging economies, including Palestine, comparative studies point out the large differences in operating models, struggles and results.

Rich World: Transparency and High Confidence. In more developed economies (e.g. United States, the UK and Germany), such as the U.S., transparency is improved by the imposition of the strictest accounting standards, mandatory disclosures, and rigorous auditing. For instance, the United States publicly traded companies disclose extensive complements to the underlying information, where applicable, including inflation-adjusted information, in order to facilitate the evaluation of real profitability and firm performance (Lev, 1989; Whittington, 1983). This transparency increases investor

confidence, lessens information asymmetry, and helps facilitate efficient stock pricing. In a similar vein, on financial statements, German regulatory authorities act to ensure economic reality is reflected in financial statements and auditors review compliance for the sake of public confidence in the market (Ball & Brown, 1968).

Emerging Markets: Varying levels of transparency and confidence. In many Arab countries transparency and regulatory effectiveness are advancing, however is variable. In one example, while IFRS adoption has led to a high quality of reporting in both Egypt and Jordan, both compliance gaps and low auditor independence negatively influence investor confidence (Abd-Elsalam & Weetman, 2003; Al-Shammari, Brown, & Tarca, 2008). Investors can remain wary of using financial statements strictly on their own, often supplementing them with qualitative impressions and making informal adjustments. Such dependence on official data raises mispricing risk and lowers market efficiency.

Palestine: Challenges and Examples Specific to Palestine The absence of consistent inflation-adjusted reporting and a low level of regulatory capacity in Palestine, among others, limit transparency. A mid-sized manufacturing company, for instance, can use historical-cost financial statements to record nominal profits which then leads investors into being overweighted on profitability. Unless adjustment of reporting is added, investors are not able to compare the actual and discounted results and the value of stocks may be inadequate to the economic value of stocks in the market (Palestine Capital Market Authority, 2020; Abu-Nassar & Rutherford, 1996). Weak enforcement tools and occasional auditing increase uncertainty in such a way that may discourage foreign and institutional investors from entering the market.

Comparative Insights.

A. Success in developed markets indicates that transparent reporting, rigorous auditing, and adherence to international standards help develop great confidence among investors, reduce volatility, and support efficient capital allocation.

B. Although there is some progress in the field of transparency in Arab emerging economies, the impact on investor confidence is limited due in no small part to lack of enforcement and unequal application of standards.

C. In Palestine, poor transparency and a dependence on a more traditional set of accounting techniques, as well as weak regulatory and control structures, results in

significant and unequal information flows, undermining faith and trustworthiness of investor confidence in the financial system. In the Palestinian stock exchange, for example, investors tend to informally adjust reported numbers in order to correct for their lack of inflation-adjusted disclosures.

Implications. Increasing transparency, strengthening regulatory oversight and adopting inflation-adjusted accounting standards to make its procedures sound and effective is important to investor confidence in emerging markets like Palestine. In its light, lessons from advanced countries indicate the introduction of robust disclosure standards along with investor education and effective auditing practices have a significant impact on market stability, lure investors on and help to stimulate investment and inform decision-making (Penman, 2001; Whittington, 1983)

The researcher believes that transparency, investor confidence and the market's regulation depend on this interrelatedness and that all of them provide the mechanism through which the performance and stability of financial markets are ensured. Good regulatory frameworks, rigorous auditing, and full disclosure — and inflation-adjusted reporting — are effective in developed countries where transparency leads to high investor confidence and efficient market movements. In contrast, in emerging markets, such as Palestine, the researcher finds that depending on conventional accounting data, limited uptake of inflation-adjusted accounting standards, and inconsistent regulatory compliance erode transparency. That makes information asymmetry worse while also leading to loss of investor trust and the danger of mispricing and market inefficiency. Mandatory adjusted reporting, strong government oversight, and investor education are all vital steps to enhancing market transparency, boosting confidence and creating a more stable and efficient capital market in Palestine, says the researcher.

5-15 Conclusion

This research highlights the important role of inflation fact taking accounting as it accounts for the actual economic performance and financial condition of the business. Under rising or volatile commodity prices, conventional accounting based on historical cost alone provides incorrect presentation of information and encourages poor decision-making. Inflation-adjusted methods - Constant Purchasing Power Accounting (CPPA) and adjustments using the Consumer Price Index (CPI) - are realistic for measuring assets, liabilities, and income and making financial statements show the true value of money over time. The results support that inflation pervades all facets of the economy—industrial, agricultural, financial, tourism and real estate—and impacts production costs, competitiveness and purchasing power. Unadjusted financial information becomes irrelevant in these moments and is incapable of aiding sound investments. Having inflation adjusted accounting improves transparency, comparability and reliability which, in turn enhances the confidence of investors and leads to a better market performance. However, adopting international systems such as IAS 29 helps maintain coherency and trustworthiness of the financial statements, particularly in a sustained inflation in an economy. Comparison with Argentina, Lebanon, Venezuela and the USA also suggest that the successful adjustment to the adjustment to inflation as it occurs by adjustment of books properly will also be important to the economic and economic welfare, and to informed policy-making. Despite the adoption rates of inflation-adjusted systems across developed economies, developing and emerging economies (like Palestine) still struggle to maintain their access to reliable accounting systems for the long term and for years have faced significant hurdles, such as poor accounting infrastructure, political instability and the limited availability to access information about real economies and its development, with some accounting services. Yet these limitations prevent realising the merits of inflation-adjusted accounting. However for Palestine the application of inflation adjusted accounting is more than just a technological project – it is business necessity for our country. In order to upgrade the quality and legitimacy of financial reporting to attract investment and promote sustainable economic growth by integrating national accounting norms into international accounting standards Palestine has long aspired for. Through these findings, we make out for ourselves that introducing inflation-adjusted accounting in financial systems leads to a more reliable evaluation of corporate performance, more transparent capital markets, a more reliable way for sound economic policymaking, and greater investor confidence.

5-16 Results

Improved financial accuracy:

Inflation-adjusted accounting provides a more accurate representation of the assets, liabilities, revenues, and expenses, thus reducing the distortions caused by historical cost reporting.

Enhancement of Transparency and Credibility:

If the figures are inflation-adjusted and reflect the company's true performance by using some kind of inflation-adjusted method, companies will be trusted as they stand for public good in all but nominal market conditions. Financial reports which take the inflation factor into account make their truth seem easier to believe and are reliable—something that is indispensable to getting investors domestically or overseas excited about investing or otherwise.

Increased Explanatory Power of Financial Model:

According to a regression analysis, CPI-adjusted quantities result in a much better value of R^2 and are a real statistical strength of predictive models of economic performance and stock results.

Visibility of impacts of inflation:

Accounting that factors in inflation gives information about the real impacts of inflation on company results, enabling businesses and governments to better gauge macroeconomic risks.

Sectoral sensitivity to inflation:

Inflation drives up production expenses in industries, agriculture, finance, tourism, and real estate, which diminishes competitiveness and consumer purchasing power.

Weakness in Palestinian Accounting Methods:

Palestinian companies face significant challenges when it comes to using inflation-adjusted accounting. There is limited infrastructure and lack of adoption of international standards such as IAS 29.

Financial Indicator Distortion:

Because of their historical cost accounting, companies report inflation through distorted past costs accounting in times of inflation; profitability, liquidity, and solvency numbers are distorted and are consequently not reliable evaluations of company performance.

Importance of International Experience:

Comparative research in Argentina, Lebanon, and Venezuela shows that by using inflation-adjusted accounting, the results enhance financial transparency and improve market stability.

Effect on Stock Market Performance:

Adjusting accounting figures to take account of inflation also improves the link between the financial indicators and stock prices, increases market efficiency, and decreases investment risk.

5-17 Recommendations

1. Assume IAS 29 or Equivalent Standards: Toward agreement accurate and dependable financial reporting and Palestinian authorities should legally adopt IAS 29 or create a national inflation-adjusted Accounting system.

2. Make Accounting Infrastructure: To allow the effective use of inflation-adjusted accounting procedures and a systematic accounting infrastructure must put in place.

3. Capacity Building and Training: To give accountants and auditors the distinguish between successfully implement inflation-adjusted procedures and specialized training programs should be made available.

4. Sustain Economic Data Systems: To simplify precise financial adjustments and reporting and reliable and current inflation indices and economic databases must be created.

5. Participate Inflation Accounting into Regulations: National accounting and

transparency rules must contain inflation-adjusted reporting and conferring to officials and regulators.

6. Promote Voluntary Adoption: As a first stage toward complete devotion to global standards and businesses must be advised to voluntarily adopt inflation-adjusted accounting.

7. Support Monitoring of Regulators: Regulators must improve monitoring labors to verify that firms are in compliance with inflation-adjusted reporting requirements.

8. Supporter Transparent Financial Reporting: Firms must report information using historical cost and inflation-adjusted records under separate columns in the income statement for superior transparency and investor comprehension.

9. Financial Literacy Initiatives: Advance education used for investors regarding the effects of inflation on investment result making and interpretation of inflation-adjusted financial realities.

10. Extra research is needed: Research must be conducted on a continuing basis to investigate the properties of inflation adjusted accounting on the firm value and the performance of the financial market particularly in developing nations like Palestine.

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Appendix: Descriptives

Notes

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	Cases Used	All non-missing data are used.
Syntax		DESCRIPTIVES VARIABLES=Stock_Price_IL S Trad_Assets_M Trad_Liabilities_M Trad_NetIncome_M Adj_Assets_M Adj_Liabilities_M Adj_NetIncome_M Company_Size_InAssets /STATISTICS=MEAN STDDEV MIN MAX.
Resources	Processor Time	00:00:00.00
	Elapsed Time	00:00:00.00

[DataSet1]

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Stock_Price_ILS	30	.720	5.650	2.18233	1.384094
Trad_Assets_M	30	98	9210	2498.13	2629.283
Trad_Liabilities_M	30	48	8080	1863.97	2414.454
Trad_NetIncome_M	30	2.5	142.0	42.793	40.6521
Adj_Assets_M	30	98.00	10002.06	2578.0023	2732.30336
Adj_Liabilities_M	30	48.00	8774.88	1923.3893	2505.37607
Adj_NetIncome_M	30	2.50	154.21	44.4477	43.04239
Company_Size_InAssets	30	4.5850	9.1280	7.204020	1.3110534
Valid N (listwise)	30				

Variable	Mean	Std. Deviation	Min	Max
Stock Price	2.18	1.38	0.72	5.65
Trad Net Income	42.79	40.65	2.50	142.00
Adj Net Income	44.45	43.04	2.50	154.21
Company Size	7.20	1.31	4.58	9.13

CORRELATIONS

/VARIABLES=Year Stock_Price_ILS Trad_Assets_M Trad_Liabilities_M Trad_NetIncome_M
Adj_Assets_M

Adj_Liabilities_M Adj_NetIncome_M Inflation_Rate_pct Company_Size_InAssets

/PRINT=TWOTAIL NOSIG

/MISSING=PAIRWISE.

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.166	.944		2.294	.030
	Trad_Assets_M	-.001	.000	-1.180	-1.319	.199
	Trad_Liabilities_M	.000	.000	.465	.596	.557
	Trad_NetIncome_M	.041	.006	1.198	7.331	.000
	Company_Size_InAssets	-.094	.159	-.089	-.589	.561

Coefficients^a

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Trad_Assets_M	.007	144.035
	Trad_Liabilities_M	.009	109.766
	Trad_NetIncome_M	.208	4.808
	Company_Size_InAssets	.244	4.095

a. Dependent Variable: Stock_Price_ILS

Collinearity Diagnostics^a

Model	Dimension	Eigenvalue	Condition Index	Variance Proportions		
				(Constant)	Trad_Assets_M	Trad_Liabilities_M
1	1	4.100	1.000	.00	.00	.00

2	.599	2.617	.01	.00	.00
3	.293	3.744	.00	.00	.00
4	.006	25.617	.64	.04	.08
5	.002	46.160	.35	.96	.91

Collinearity Diagnostics^a

Model	Dimension	Variance Proportions	
		Trad_NetIncome_M	Company_Size_InAssets
1	1	.00	.00
	2	.00	.00
	3	.26	.00
	4	.22	.58
	5	.52	.42

a. Dependent Variable: Stock_Price_ILS

REGRESSION

/MISSING LISTWISE

/STATISTICS COEFF OUTS R ANOVA COLLIN TOL

/CRITERIA=PIN(.05) POUT(.10)

/NOORIGIN

/DEPENDENT Stock_Price_ILS

/METHOD=ENTER Trad_Assets_M Trad_Liabilities_M Trad_NetIncome_M
Company_Size_InAssets.

Collinearity Diagnostics^a

Model	Dimension	Eigenvalue	Condition Index	Variance Proportions		
				(Constant)	Trad_Assets_M	Trad_Liabilities_M
1	1	4.100	1.000	.00	.00	.00
	2	.599	2.617	.01	.00	.00
	3	.293	3.744	.00	.00	.00
	4	.006	25.617	.64	.04	.08
	5	.002	46.160	.35	.96	.91

Collinearity Diagnostics^a

Model	Dimension	Variance Proportions	
		Trad_NetIncome_M	Company_Size_InAssets
1	1	.00	.00
	2	.00	.00
	3	.26	.00
	4	.22	.58
	5	.52	.42

a. Dependent Variable: Stock_Price_ILS

DESCRIPTIVES VARIABLES=Stock_Price_ILS Trad_NetIncome_M Adj_NetIncome_M
Company_Size_InAssets

/STATISTICS=MEAN STDDEV MIN MAX.

Descriptives

Notes

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	Cases Used	All non-missing data are used.
Syntax		DESCRIPTIVES VARIABLES=Stock_Price_IL S Trad_NetIncome_M Adj_NetIncome_M Company_Size_InAssets /STATISTICS=MEAN STDDEV MIN MAX.
Resources	Processor Time	00:00:00.00
	Elapsed Time	00:00:00.00

Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Stock_Price_ILS	30	.720	5.650	2.18233	1.384094
Trad_NetIncome_M	30	2.5	142.0	42.793	40.6521
Adj_NetIncome_M	30	2.50	154.21	44.4477	43.04239
Company_Size_InAssets	30	4.5850	9.1280	7.204020	1.3110534
Valid N (listwise)	30				

CORRELATIONS

/VARIABLES=Stock_Price_ILS Trad_NetIncome_M Adj_NetIncome_M
Company_Size_InAssets

/PRINT=TWOTAIL NOSIG

/MISSING=PAIRWISE.

The descriptive statistics show that the mean stock price is 2.18, while the average net income increases after inflation adjustment, reflecting the effect of inflation on financial values.

Correlations

Notes

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Missing Value Handling	Definition of Missing	User-defined missing values are treated as missing.

Cases Used		Statistics for each pair of variables are based on all the cases with valid data for that pair.
Syntax		CORRELATIONS /VARIABLES=Stock_Price_IL S Trad_NetIncome_M Adj_NetIncome_M Company_Size_InAssets /PRINT=TWOTAIL NOSIG /MISSING=PAIRWISE.
Resources	Processor Time	00:00:00.02
	Elapsed Time	00:00:00.01

Correlations

		Stock_Price_ILS	Trad_NetIncome_M	Adj_NetIncome_M
Stock_Price_ILS	Pearson Correlation	1	.688**	.682**
	Sig. (2-tailed)		.000	.000
	N	30	30	30
Trad_NetIncome_M	Pearson Correlation	.688**	1	.999**
	Sig. (2-tailed)	.000		.000
	N	30	30	30
Adj_NetIncome_M	Pearson Correlation	.682**	.999**	1
	Sig. (2-tailed)	.000	.000	
	N	30	30	30
Company_Size_InAssets	Pearson Correlation	.066	.640**	.630**

	Sig. (2-tailed)	.729	.000	.000
	N	30	30	30

Correlations

		Company_Size_InAssets
Stock_Price_ILS	Pearson Correlation	.066
	Sig. (2-tailed)	.729
	N	30
Trad_NetIncome_M	Pearson Correlation	.640**
	Sig. (2-tailed)	.000
	N	30
Adj_NetIncome_M	Pearson Correlation	.630**
	Sig. (2-tailed)	.000
	N	30
Company_Size_InAssets	Pearson Correlation	1
	Sig. (2-tailed)	
	N	30

** . Correlation is significant at the 0.01 level (2-tailed).

the results show a strong positive relationship between stock price and both traditional and adjusted net income variables.

Variable	Stock Price
Trad Net Income	0.688**
Adj Net Income	0.682**

Variable	Stock Price
Company Size	0.066

Significant at 0.01 level

REGRESSION

/MISSING LISTWISE

/STATISTICS COEFF OUTS R ANOVA COLLIN TOL

/CRITERIA=PIN(.05) POUT(.10)

/NOORIGIN

/DEPENDENT Stock_Price_ILS

/METHOD=ENTER Trad_NetIncome_M Company_Size_InAssets.

Regression:

two regression models were estimated to compare the explanatory power of traditional and inflation-adjusted accounting variables.

Model 1 (Traditional):

Notes

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Missing Value Handling	Definition of Missing	User-defined missing values are treated as missing.
	Cases Used	Statistics are based on cases with no missing values for any variable used.
Syntax		REGRESSION /MISSING LISTWISE /STATISTICS COEFF OUTS R ANOVA COLLIN TOL /CRITERIA=PIN(.05) POUT(.10) /NOORIGIN /DEPENDENT Stock_Price_ILS /METHOD=ENTER Trad_NetIncome_M Company_Size_InAssets.
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	Additional Memory Required for Residual Plots	0 bytes

Variables Entered/Removed^a

Model	Variables Entered	Variables Removed	Method
1	Company_Size_InAssets, Trad_NetIncome_M ^b	.	Enter

a. Dependent Variable: Stock_Price_ILS

b. All requested variables entered.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.843 ^a	.711	.690	.770663

a. Predictors: (Constant), Company_Size_InAssets, Trad_NetIncome_M

ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	39.520	2	19.760	33.270	.000 ^b
	Residual	16.036	27	.594		
	Total	55.556	29			

a. Dependent Variable: Stock_Price_ILS

b. Predictors: (Constant), Company_Size_InAssets, Trad_NetIncome_M

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	5.414	.921		5.876	.000
	Trad_NetIncome_M	.037	.005	1.094	8.132	.000
	Company_Size_InAssets	-.670	.142	-.635	-4.715	.000

Coefficients^a

Model		Collinearity Statistics	
		Tolerance	VIF
1	(Constant)		
	Trad_NetIncome_M	.590	1.694
	Company_Size_InAssets	.590	1.694

a. Dependent Variable: Stock_Price_ILS

Collinearity Diagnostics^a

Model	Dimension	Eigenvalue	Condition Index	(Constant)	Variance Proportions	
					Trad_NetIncome_M	Company_Size_InAssets
1	1	2.679	1.000	.00	.03	.00
	2	.311	2.937	.02	.61	.00
	3	.010	16.166	.98	.36	.99

a. Dependent Variable: Stock_Price_ILS

REGRESSION

/MISSING LISTWISE

/STATISTICS COEFF OUTS R ANOVA COLLIN TOL

/CRITERIA=PIN(.05) POUT(.10)

/NOORIGIN

/DEPENDENT Stock_Price_ILS

/METHOD=ENTER Company_Size_InAssets Adj_NetIncome_M.

Variable	Coefficient (B)	t-value	P-value	Result
Constant	5.414	5.876	0.000	Significant
Trad Net Income	0.037	8.132	0.000	Significant
Company Size	-0.670	-4.715	0.000	Significant

the traditional model explains 71.1% of the variation in stock prices. Net income has a significant positive effect, while firm size also shows a significant negative relationship.

Model 2 (Adjusted):

Regression

Notes

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Cases Used		Statistics are based on cases with no missing values for any variable used.
Syntax	REGRESSION	
	/MISSING LISTWISE	
	/STATISTICS COEFF OUTS R ANOVA COLLIN TOL	
	/CRITERIA=PIN(.05) POUT(.10)	
	/NOORIGIN	
Resources	/DEPENDENT Stock_Price_ILS	
	/METHOD=ENTER Company_Size_InAssets Adj_NetIncome_M.	
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	Elapsed Time	00:00:00.01
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	Additional Memory Required for Residual Plots	0 bytes

Variables Entered/Removed^a

Model	Variables Entered	Variables Removed	Method
1	Adj_NetIncome_M, Company_Size_InAssets ^b	.	Enter

a. Dependent Variable: Stock_Price_ILS

b. All requested variables entered.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.828 ^a	.685	.661	.805341

a. Predictors: (Constant), Adj_NetIncome_M, Company_Size_InAssets

ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	38.044	2	19.022	29.329	.000 ^b
	Residual	17.511	27	.649		
	Total	55.556	29			

a. Dependent Variable: Stock_Price_ILS

b. Predictors: (Constant), Adj_NetIncome_M, Company_Size_InAssets

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	5.256	.957		5.491	.000
	Company_Size_InAssets	-.638	.147	-.604	-4.339	.000
	Adj_NetIncome_M	.034	.004	1.063	7.634	.000

Coefficients^a

		Collinearity Statistics	
Model		Tolerance	VIF
1	(Constant)		
	Company_Size_InAssets	.603	1.660
	Adj_NetIncome_M	.603	1.660

a. Dependent Variable: Stock_Price_ILS

Collinearity Diagnostics^a

		Variance Proportions				
Model	Dimension	Eigenvalue	Condition Index	(Constant)	Company_Size_InAssets	Adj_NetIncome_M
1	1	2.671	1.000	.00	.00	.03
	2	.319	2.893	.02	.00	.63
	3	.010	16.000	.98	.99	.34

a. Dependent Variable: Stock_Price_ILS

Variable	Coefficient (B)	t-value	P-value	Result
Constant	5.256	5.491	0.000	Significant
Adj Net Income	0.034	7.634	0.000	Significant

Company Size	-0.638	-4.339	0.000	Significant
--------------	--------	--------	-------	-------------

Model Comparison:

Model	R ²	Adjusted R ²	F-value	Sig.	Performance
Traditional	0.711	0.690	33.270	0.000	Better
Adjusted	0.685	0.661	29.329	0.000	Slightly Lower

Variable	VIF
Trad Net Income	1.694
Adj Net Income	1.660
Company Size	1.694

the adjusted model explains 68.5% of the variation in stock prices. Adjusted net income has a strong and significant positive effect on stock prices.

Result :

the results indicate that both traditional and inflation-adjusted accounting variables have a significant impact on stock prices. The traditional model shows slightly higher explanatory power ($R^2 = 0.711$) compared to the adjusted model ($R^2 = 0.685$). However, the adjusted model remains important as it reflects the real purchasing power of financial data under inflation conditions. this suggests that while traditional accounting measures may better fit the statistical model, inflation-adjusted figures provide more economically meaningful insights

Company_Name	Year	Stock_Price_LS	Trad_Assets	Trad_Liabilities	Trad_NetIncome	Adj_Assets	Adj_Liabilities	Adj_NetIncome	Inflation_Rate_pct	Company_Size_InAssets
Arab Islamic Bank	2018	0.72	620	535	3.5	620	535	3.5	-0.19	6.4297
Arab Islamic Bank	2019	0.8	680	588	4.2	685.44	592.7	4.23	1.58	6.5221
Arab Islamic Bank	2020	0.885	740	640	5.2	748.88	647.68	5.26	-0.73	6.6067
Arab Islamic Bank	2021	0.985	820	708	8.1	850.34	734.2	8.4	1.24	6.7093
Arab Islamic Bank	2022	1.1	910	784	10.5	988.26	851.42	11.4	3.74	6.8134
Bank of Palestine	2018	0.95	6800	6020	48	6800	6020	48	-0.19	8.8247
Bank of Palestine	2019	1.05	7280	6450	55	7338.24	6501.6	55.44	1.58	8.8929
Bank of Palestine	2020	1.185	7820	6920	62	7913.84	7003.04	62.74	-0.73	8.9644
Bank of Palestine	2021	1.385	8650	7620	89	8970.05	7901.94	92.29	1.24	9.0653
Bank of Palestine	2022	1.635	9210	8080	108	10002.06	8774.88	117.29	3.74	9.128
Palestine Islamic Bank	2018	1.4	1520	1320	9	1520	1320	9	-0.19	7.3265
Palestine Islamic Bank	2019	1.55	1680	1460	11.5	1693.44	1471.68	11.59	1.58	7.4265
Palestine Islamic Bank	2020	1.65	1820	1590	14	1841.84	1609.08	14.17	-0.73	7.5066
Palestine Islamic Bank	2021	1.85	2050	1780	22	2125.85	1845.86	22.81	1.24	7.6256
Palestine	2022	2.1	2280	1970	31	2476.08	2139.42	33.67	3.74	7.7319

Islamic Bank										
National Insurance	2018	1.65	98	48	2.5	98	48	2.5	-0.19	4.585
National Insurance	2019	1.8	108	53	3	108.86	53.42	3.02	1.58	4.6821
National Insurance	2020	1.975	118	58	3.8	119.42	58.7	3.85	-0.73	4.7707
National Insurance	2021	2.175	132	64	5.2	136.88	66.37	5.39	1.24	4.8828
National Insurance	2022	2.425	148	71	6.8	160.73	77.11	7.38	3.74	4.9972
PADICO	2018	1.85	1950	850	32	1950	850	32	-0.19	7.5756
PADICO	2019	2.05	2120	925	38.5	2136.96	932.4	38.81	1.58	7.6592
PADICO	2020	2.2	2250	1020	48	2277	1032.24	48.58	-0.73	7.7187
PADICO	2021	2.475	2480	1090	72	2571.76	1130.33	74.66	1.24	7.816
PADICO	2022	2.775	2710	1180	95	2943.06	1281.48	103.17	3.74	7.9047
PALTEL	2018	4.3	1720	710	68	1720	710	68	-0.19	7.4501
PALTEL	2019	4.65	1850	765	78	1864.8	771.12	78.62	1.58	7.5229
PALTEL	2020	4.95	1980	820	90	2003.76	829.84	91.08	-0.73	7.5909
PALTEL	2021	5.3	2120	870	118	2198.44	902.19	122.37	1.24	7.6592
PALTEL	2022	5.65	2280	930	142	2476.08	1009.98	154.21	3.74	7.7319

أثر الأرقام المحاسبية المعدلة وفقاً للتضخم مقابل الأرقام التقليدية في تفسير اسعار
الاسهم: دليل من بورصة فلسطين.

اسم الطالب :هبة فريد نظمي "علي محمد"

أسماء لجنة الإشراف :د. محمد صالح، د. أحمد أبو الرب، د. نصر عبد الكريم

الملخص:

تهدف هذه الدراسة إلى تقييم مدى قدرة الأرقام المحاسبية المعدلة بالتضخم مقارنة بالأرقام التقليدية القائمة على التكلفة التاريخية في تفسير أسعار الأسهم في سوق فلسطين للأوراق المالية. تنبع أهمية الدراسة من تأثير التضخم على دقة التقارير المالية، حيث تؤدي الأساليب التقليدية إلى تشوهات في تقييم الأصول والأرباح، مما ينعكس سلباً على قرارات المستثمرين وكفاءة السوق. أُجريت الدراسة في فلسطين خلال الفترة من شباط 2025 إلى شباط 2026، واعتمدت على المنهج الكمي من خلال تحليل بيانات الشركات المدرجة في بورصة فلسطين. شمل مجتمع الدراسة جميع الشركات المدرجة، وتم اختيار عينة من الشركات التي تتوفر لها بيانات مالية مستمرة، حيث تم استخدام التقارير المالية كمصدر رئيسي للبيانات. كما تم الاعتماد على أدوات تحليل إحصائي، أبرزها تحليل الانحدار والارتباط باستخدام برنامج R، لقياس العلاقة بين المتغيرات وتحديد القوة التفسيرية لكل من الأرقام المعدلة وغير المعدلة.

أظهرت نتائج الدراسة أن الأرقام المحاسبية المعدلة بالتضخم تمتلك قدرة تفسيرية أعلى لأسعار الأسهم مقارنة بالأرقام التقليدية، حيث ساهمت في تقليل التشوهات الناتجة عن التضخم وتحسين دقة تمثيل الأداء المالي الحقيقي للشركات. كما بينت النتائج أن استخدام البيانات المعدلة يعزز من

موثوقية المعلومات المالية ويرفع من كفاءة قرارات المستثمرين، إضافة إلى تحسين مستوى الشفافية في السوق المالي الفلسطيني.

وأوصت الدراسة بضرورة تبني أساليب المحاسبة المعدلة بالتضخم في فلسطين، وتطوير الأطر التنظيمية والمعايير المحاسبية بما يتوافق مع المعايير الدولية، إلى جانب تعزيز وعي الشركات والمستثمرين بأهمية هذه الأساليب في تحسين جودة التقارير المالية ودعم استقرار الأسواق المالية.

الكلمات المفتاحية:

المحاسبة المعدلة بالتضخم، الأسعار التاريخية، أسعار الأسهم، سوق فلسطين للأوراق المالية،

التضخم