Models of accounting analysis

Historic Cost

In accounting, historic cost is the first money related quality of a financial item. Historic cost is focused around the stable measuring unit assumption. In a few circumstances, assets and liabilities may be demonstrated at their historic cost, as though there had been no change in value from the date of acquisition. The balance sheet value items may subsequently vary from the “ accurate” value (WIKIPEDIA).

Principle

An accounting system in which assets are recorded on an balance sheet with the value at which they were obtained, rather than the current market value. The historic cost standard is used to get the measure of capital expended to acquire an asset, and is helpful for matching against changes in profits or expenses identifying with the asset purchased, and in addition for deciding past opportunity costs (Business Dictionary).

Impacts

Under the historical cost basis of accounting, assets and liabilities are recorded at their values when first acquired. They are not then generally restated for changes in values. Costs recorded in the Income Statement are based on the historical cost of items sold or used, rather than their replacement costs (WIKIPEDIA).

Example

The main headquarters of a company, which includes the land and building, was bought for $100, 000 in 1945, and its expected market value today is $30 million. The asset is still recorded on the balance sheet at $100, 000 (INVESTOPEDIA).

Current Purchasing Power Accounting

Capital maintenance in units of constant purchasing power (CMUCPP) is the International Accounting Standards Board (IASB) basic accounting model originally authorized in IFRS in 1989 as an alternative to traditional historical cost accounting (WIKIPEDIA).

Principle

Current Purchasing Power Accounting(CPPA) includes the re-statement of historical figures at current purchasing power. For this reason, historic figures must be multiple by conversion factors. The formula for the calculation of conversion component is:

Conversion factor = Price Index at the date of Conversion/Price Index at the date of item arose

Conversion factor at the beginning = Price Index at the end/Price Index at the beginning

Conversion factor at an average = Price Index at the end/Average Price Index

Conversion factor at the end = Price Index at the end/Price Index at the end

Average Price Index = Price Index at beginning + Price Index at the end/2

CPP Value = Historical value X Conversion factor (Account Managment Economics).

Impacts on Financial Statements

financial statements are ready on the basis of historical cost and a supplementary statement is ready showing historical items in terms of present value on the basis of general price index. Retail price index or wholesale price index is taken as an appropriate index for the conversion of historical cost items to show the changes in value of money. This method takes into consideration the changes in the value of items as a result of general price level, but it does not account for changes in the value of individual items (Accounting Managment).

Example

XYZ Company had a closing balance of inventory at 30 June 2012 equal to $10000. This inventory had been purchased in the last three months of the financial year. Assume the general price level index was 140 on 1 July 2011, 144 on 31 December 2011, 150 on 30 June 2012, the average for the year (July 2011-June 2012) was 145 and the average for April 2012 – June 2012 was 147. For showing updated inventory with CPPA, we will use following formula Book value of inventory X current month general price index/ average index of three months = 10000 X 150/ 147 = $ 10204 (Accounting Education).

Current Cost Accounting

Current cost accounting is a procedure of accounting that attempts to give quality of benefits on the basis of their current replacement require as opposed to the sum they were purchased for (Ask).

Principles

It influences all the records and accounting reports also their balancing items. A fundamental principle underlying the estimation of gross value added, and hence GDP, is that yield and intermediate utilization must be value at the costs present at the time the processing happens. This intimates that goods withdrawn from inventories must be value at the price prevailing at the times the goods are withdrawn and not at the costs at which they entered inventories (Glossary Of Statistical Terms).

Impacts

Accounting systems that help in the preparation of financial reports, the cost accounting systems and reports are not subject to rules and standards like the Generally Accepted Accounting Principles. As a result, there is huge variety in the cost accounting systems of the different organization and sometimes even in different parts of the same organization (WIKIPEDIA).

Advantages Of Historic Cost

Historic Cost provide straight forward procedure. It records gains until they are recognize. Historical Costing method are still using in accounting system.

Dis-Advantages Of Historic Cost

Historic Cost consider as a acquisition cost of an asset and does not recognize current market value. Historic Cost only interested in allocation of cost, not in the value of an asset. It's neglect the current market value of the asset that may be higher or lower than its suggested. It's gives flaws in time of inflation (Study Mode).

Comments

Historical Costing method is still using in accounting system, it is a traditional method of accounting system it is not represent the market value of items, due to which it is not a appropriate method to adopt.

Advantages Of Current Purchasing Power Accounting

- Current purchasing power method uses as measuring unit.
- It's provide the calculation facilities to gain or loss in purchasing power due to holding monetary items.
- In this method, historical accounts continue to be maintained because they prepared on supplementary basis.
- This method intact the purchasing power of capital contributed by shareholders, so the method is important from the shareholders point of view.
- This method provides reliable financial information for the management to formulate policies and plans.

Dis-Advantages Of Current Purchasing Power Accounting

- This method is only consider changes in general purchasing power, it does not consider the changes in the value of individual items.

- This method based on statistical index number which not used in individual firm.
- It's difficult to use suitable price index.
- This method is failed to remove all defects of historical cost accounting system (Accounting Management).

Comments

Purchasing power accounting is very useful to provide financial information for management and its intact the purchasing power of capital which contributed by shareholders, its useful in inflation time so now in current time this method is very useful.

Advantages of Current Cost Accounting

- This methods use present value of assets, instead of the original purchase price.
- This type of accounting is addresses the difference between historical and current cost accounting system.
- This method assigns higher values on the assets owned by the business.
- This method also used during bankruptcy and liquidation procedures to find the total loss to the owner (Ask).

Comments

Cost accounting provides accurate situation of the connection between specific cost and specific outputs because traces resources as they moves through company. By adopting cost accounting for business, in that way we learn resources are being wasted and which resource are most profitable (Chron).