Historical cost accounting advantages and disadvantages

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Financial policy and accounting

Financial policy is to determines hoe a business is to be financed, whether by equity or preference share capital, and extent to which reliance is to be placed upon long term or short term borrowing. In addition the credit and discount policies followed to be determined policies companies have a duty to publish account

Historical costing

Historical cost is the original monetary value of an economic item. Historical is based on the stable measuring unit's assumption

Historical cost accounting is the situation in which accountants record revenue, expenditure and asset acquisition and disposal at historical cost: that is, the actual amounts of money, or money's worth, received or paid to complete the transaction.

Historical cost accounting is also called because it concern itself with the recording of actual cost on after the date when these are in cured. There are two basic costing system 1 is job costing and 2 is process costing. Actual cost is the part of most modern standard costing system but they are limited value.

A basis for the treatment of assets in financial statements where they are recorded at their historical cost, without adjustment for inflation or other price variations

What is historical cost accounting?

Historical cost is a term used instead of the cost. Cost and historical cost usually mean the original cost at the time of a transaction. Historical cost is helps to distinguish an asset's original cost from its replacement cost, current cost, or inflation-adjusted cost.

Example,

Land purchased in 1992 at cost of $80, 000 and still owned by the buyer will be reported on the buyer's balance sheet at its cost or historical cost of $80, 000 even though its current cost, replacement cost, and inflation-adjusted cost is much higher today.

The cost principle or historical cost principle states that an asset should be reported at its cost (cash or cash equivalent amount) at the time of the exchange transaction and should include all costs necessary to get the asset in place and ready for use.

Historical cost principle in accounting

Historical cost principle means that assets and liabilities are recorded at their actual historical cost. When an asset is written off, the loss is recorded as the historical cost of the asset less any accumulated depreciation. Typically, the asset would be fully depreciated and thus no loss recorded but this isn't always the case.

If the asset is sold the gain or loss is recorded as the amount received for the asset less the historical cost (net of any accumulated depreciation). In both cases, you're using the historical cost as your basis in the asset, but in the

write off, you didn't receive anything in return for the asset. To record a sale, you must account for the payment you receive and that amount is of course, the current value of the asset – at least its value to someone (the purchaser).

Advantages and disadvantages of historical cost accounting

Advantages

Historical cost accounts are straightforward to produce

Historical cost accounts do not record gains until they are realized

Historical cost accounts are still used in most accounting systems

Disadvantages

Historical cost accounts give no indication of current values of the assets of a business

Historical cost accounts do not record the opportunity costs of the use of older assets, particularly property which may be recorded at a value based on costs incurred many years ago

Historical cost accounts do not measure the loss of value of monetary assets as a result of inflation.

Standard costing

Standard costing is an important topic of cost accounting. Standard costs are generally connected with a manufacturing company's costs of direct material, direct labor, and manufacturing overhead.

Rather than conveying the actual costs of direct material, direct labor, and manufacturing overhead to a product, several manufacturers allocate the expected or standard cost. This means that a manufacturer's inventory and cost of goods sold will begin amounts reflecting the standard costs, not the actual costs, of a product. Manufacturers, at rest to pay the actual costs. As a result there are almost always differences between the actual costs and the standard costs, and those differences are known as variances.

Standard costing and the related variances is a valuable management tool. If a variance arise, management becomes aware that manufacturing costs have different form the standard (planned, probable) costs.

If actual costs are greater than standard costs the variance is unfavorable. An unfavorable variance tells management that if everything else stays constant the company's actual profit will be less than planned.

If actual costs are less than standard costs the variance is favorable. A favorable variance tells management that if everything else stays constant the actual profit will likely exceed the planned profit.

The earlier that the accounting system reports a variance, the earlier that management can direct its notice to the difference from the planned amounts.

If we assume that a company uses the perpetual inventory system and that it carry all of its inventory accounts at standard cost (including Direct Materials Inventory or Stores), then the standard cost of a finished product is the sum of the standard costs of the inputs:

1. Direct material

2. Direct labor

3. Manufacturing overhead

a. Variable manufacturing overhead

b. Fixed manufacturing overhead

Standard costs are those cost which are established through identify an objective connection between specific inputs and estimated outputs. Standard costs are usually related to warily analyze phenomenon both in the laborator and in the work place.

Marginal costing

Marginal cost is the variable cost of one unit product or service.

Marginal cost is alternative method of costing to absorption costing. Marginal cost is variable cost charged as a cost of sale and a contribution cost is calculate (sale revenue minus variable cost of sale). Closing stock of work in progress or finished goods are value at the marginal (variable) production cost. Fixed cost is treating as a period cost and charged into the profit and loss account incurred the period of accounting

Marginal production cost per unit of an item usually consists of the following.

Direct material

Direct labour

production overheads

Direct labour cost might be excluded from marginal costs when the work force is given number of employees on a fixed wages of salary. Even so it is not uncommon for direct labour to be treated as variable cost. When employee are paid a basic wage for a fixed working period. If in doubt you should tread direct labour as a variable cost unless given clear indicator to the country. Direct labour is a often steep cost. With sufficiently short step to be make a labour cost in a variable.

The marginal cost of asset usully consist of the marginal cost of production adjusted for stick movement plus the variable selling cost

The most important feature of marginal costing is the division of cost into those which are marginal (variable) those which are fixed. The latter are not apportioned to cost centers or products as under and other costing system. Instead they are charged against sale revenues within the period in which are incurred. this deviation of the cost are there application in a appropriate manner is extremely use full in showing management the effect decision, particularly those connected with short term utilization of production capacity.

Principles of marginal costing:

The marginal principal costing are as

Period fixed cost are same any volume of sales and production (provided the level of activity within the relevant range) . selling by an extra item product or service following are as

Revenue will be increase by the sale volume of sold item

Cost will be increase by the per unit cost

Profit will be increase by the contribution amount earned from the extra item

The volume of sales falls by one item. Profit will be fall by amount of earned contribution item

Profit is measurement should be based on analysis of total contribution.

When a unit product is made the extra cost incurred for the manufacture variable

Production cost. fixed costs are unaffected, no extra fixed cost are incurred when output is increased. The valuation of closing stock should be at variable production cost

Decision accounting

The comparison of an alternative courses of action may be facilitated the use of cost data. Latter may be collected by part of a routine or deal with the special problems when it arise strictly speaking, this is not a separate system. It calls upon another information system which indicates the management project likely maximum profit & minimum loss. decision on capital expenditure whether to make or buy., what price should be charged as to subcontract and other important matter may all be assisted by the employment of accounting information. A few words on the role of decision making are very appropriate stage.

One of the most important function of top management is to make decision. Irrespective of the method of employed decision making implies a choice from a number of alternative. Ther are two basic selection methods

First the selection of the particular field in which the final decisions to be made, production is increased, the labour force may large new machine may be introduced: if sale are to be expanded the initial choice between employing more sales men identifying the advertisement to other sale publicity. Once a initial selection has been made, second choice must be follow, if machine is to be purchased

Control accounting

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