



Peter Burgess LinkedIn Blogs

Making Conventional Accounting More Relevant

Conventional accounting is very powerful and at the center of every good corporate management information system. A well managed business knows how costs behave and is therefore in a position to optimize the way the company operates so that costs are minimized while revenues are maximized. It is cost accounting, a subset of business accounting, that provides the decision making information.

An equivalent subset of business accounting is needed to provide information about impact on people and planet, an accounting module that includes externalities in a coherent way.

Cost accounting enables an analysis of 'cost of sales' from a money profit perspective. Impact accounting will enable an analysis of a number of specific important 'expenditure accounts' in the profit and loss account ... specifically:

1. payroll;
2. energy;
3. taxes;
4. non-business pro-good expenditures; and
5. purchased materials.

PAYROLL

When payroll goes down, profits go up. But when payroll goes down, the employee earns less or nothing at all. This has a direct impact on an individual's quality of life.

There is a 'knock-on' effect in that the family of the individual is all impacted.

There is a further 'knock on' effect because of the 'local multiplier' in the community where the individual and the family lives.

The impact of payroll is not only a function of its aggregate size, it is also a function of how wages are distributed between different people. A low wage that changes results in a bigger impact change than a high wage that changes. At some level of remuneration, a change in remuneration has very little impact on socio-economic performance ... and this level is now a small fraction of what many C-level executives are now being paid.

ENERGY

With regard to energy, the use of energy enables things to be done than cannot be done without the use of energy. This is a positive thing, but at the same time the use of energy has an impact on resources ... resource depletion ... and on environment ... environmental degradation. Energy is used in factory processes, in offices and in transportation.

Environmental degradation has many forms. In the immediate post-war (WWII) years in Europe and North America environmental degradation was visible as particulate pollution and smog (sulphur dioxide, nitrous oxides, etc.) and continuing to be an issue in big cities around the world. But now environmental degradation also includes greenhouse gases like carbon dioxide and methane which are aggravating the problem of global warming and climate change.

TAXES

Taxes are a charge against the business income that reduces the surplus available for the owners or investors. But taxes are also a key part of the economic flow because they fund government, and in turn, government provides important services for society. The problem of inadequate funding of government is an emerging crisis not much in the media. Almost every government entity on the planet is essentially bankrupt, and stays afloat by cutting back on all sorts of essential services. In the United States, for example, the unfunded future pension obligations are serious, as is the backlog of maintenance and upgrading for the infrastructure.

PRO-GOOD EXPENDITURES

Non-business pro-good expenditures are a cost that reduces profit, but also reduces taxation. Some will argue that these expenditures are good for the company because they improve the company's image, and in turn this results in better business performance. But beyond the cost and benefit for the company, pro-good expenditures can be of very significant social value which can be relatively easily recorded and become the basis for rigorous reporting.

PURCHASED MATERIALS

Purchased materials is recorded in the financial accounts simply as an amount purchased and a money amount paid. However, embedded in this is the whole story of the supply chain for these materials.

When PUMA prepared an Environmental Profit and Loss Account (EP&L) in 2010, they realized that more than 90% of the 'impact' on the environment occurred in the supply chain rather than in PUMA's own operations. This is not unusual, but rather typical of many modern industries and ultra-large organizations.

This makes understanding the embedded story in purchased materials very important. The money cost of purchased materials needs to be able to be 'exploded' to show some detail of the story ... specifically the impact elements identified earlier, plus the profit that is embedded at each stage.

PRODUCTS

The products coming out of an organization have a price that converts into revenue for the company, but in addition these products are carrying the embedded story of their creation.

DATA SYSTEMS

Implementing a system of impact accounting that works is going to be like implementing a cost accounting system that works. In cost accounting, it is very easy to have a huge amount of detail that has no meaning, but there are ways to make cost accounting efficient and very useful. One of these techniques is the use of standard costs. In the case of impact accounting, the equivalent concept is the use of standard values.

Materiality is another idea that will help in making impact accounting meaningful and practical. What is material becomes clear at a fairly early stage in the implementation of most 'numbers based' analysis systems.

Making conventional accounting more relevant by adding an impact accounting module is becoming quite critical. The CEOs of a growing number of companies are talking about sustainability, CSR, environment, etc. which is encouraging.

THIS IS THE TIME

The need for metrics to support this talk has been recognized, and all sorts of reporting initiatives are at various stages of development and deployment. Most of these have a focus on reporting and are not particularly well integrated yet into the conventional accounting systems and are likely to result in significant duplication of effort.

My hope is that accountants will see impact accounting as an important step forward in making conventional accounting more relevant.

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