Community Accountancy

PUTTING ACCOUNTANCY TO WORK FOR ALL OF SOCIETY

STANDARDS AND VARIANCES

FOR DISCUSSION ONLY

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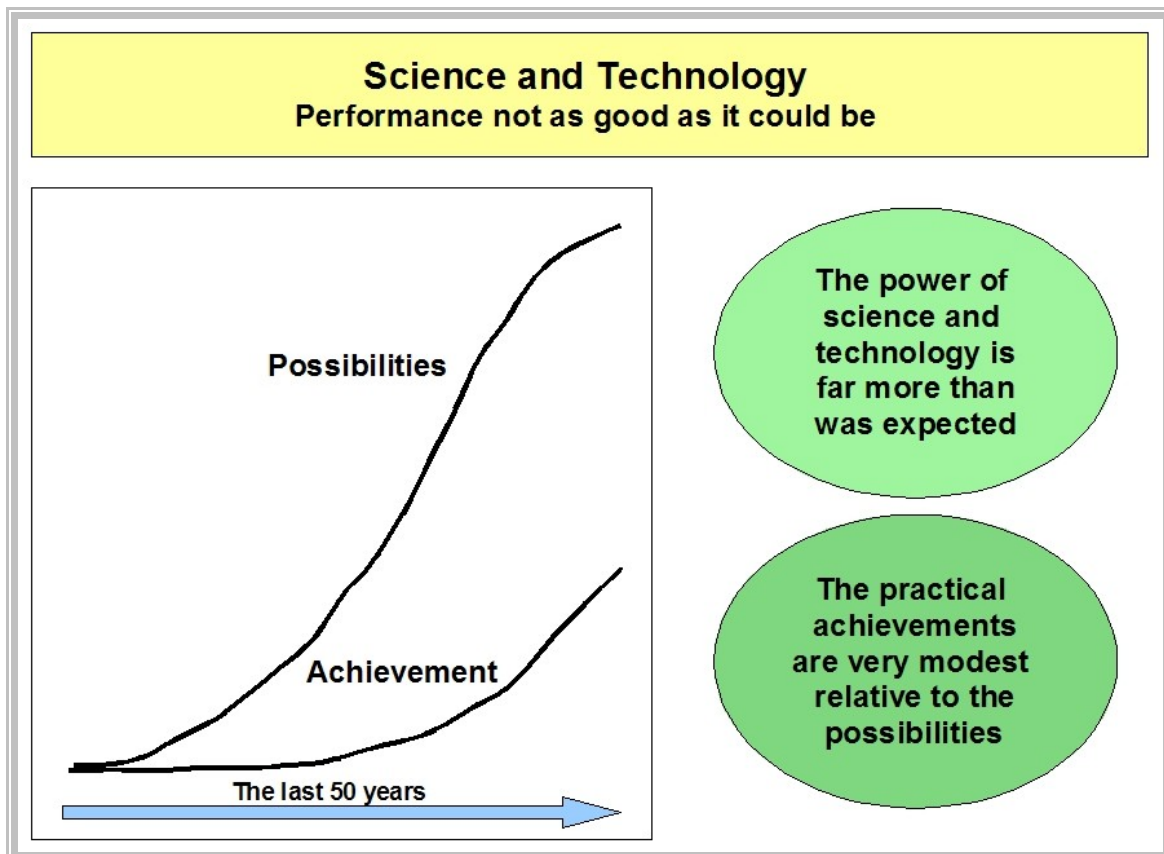**July 2008**

STANDARDS
AND VARIANCES

WHY COMPARISON?

What it is ... what should it be?

One of the continuing questions should be know not only what it is but also what it should be. This is a simple question and an important question.

It is also a question that much of society does not want to address. The answers are uncomfortable. Why is it that science and technology can put man on the moon, but food for people on this planet is too difficult.

Community Accountancy is a system that can help to explain why the system is not working and what needs to be done to put things right. Community Accountancy is not the answer ... merely a powerful tool to find the answers, and to monitor progress.

Science and Technology
Performance not as good as it could be

Possibilities

Achievement

The last 50 years

The power of science and technology is far more than was expected

The practical achievements are very modest relative to the possibilities

STANDARDS

Common usage

The idea of a standard is common ... it may be described as the norm ... it is what is expected. It is an idea that is ubiquitous. But it is also a concept that is absent in the metrics of socio-economic performance and impact on community.

STANDARDS

Standard cost accounting
Standard costs ...

Standard cost accounting is a tool that has helped cost accountants measure cost performance without getting deeply buried in detail.

Standard costs are the theoretical cost that an item or service should have ... and when the actual costs are different, then it is time to find out why.

The Tr-Ac-Net system structures knowledge about costs so that this knowledge can be used to compare what things are costing with what they should be costing. The system helps to clarify what is cost that is justified, and what is cost that merely reflects some aberration in the procurement and implementation system.

Standard costs are a way of making better use of cost data. With standard costing it is possible to compare the actual cost performance with what it should have been.

In Community Accountancy the idea of standard cost is also applied to value and used in the determination of community progress or added value. This is very useful where "value" varies between different groups and all views need to be take into account.

Standard value accounting
Standard values ...

The same approach is used for value as for cost.

Every activity produces something ... what is the standard value of this output? This can be determined in an arbitrary manner, and then it can be used in an analytical framework, and compared to alternative values that are justified from different other perspectives.

The common standard allows comparison across geography and projects ... while not excluding alternative perspectives.

In Community Accountancy the idea of standard costs is also applied to value. The concept of standard value greatly simplifies the determination of community progress and added value.

Value is very subjective. A standard value provides for many different perspectives of value to be incorporated into analysis while also having some way to compare value adding in a uniform way across many communities.

Standard, actual and variance

Having cost standards may be interesting, but usually not very useful until they are compared in some way with the actual costs ... the variances analyzed.

When there is variance analysis, it is possible to find information that is simply wrong ... or performance that is quite different from what had been assumed. All interesting and important ... and a guide to hat needs to be done to have improvement.

Standard, actual and variance is a basic of performance assessment ... and tells how actual results where relative to what the results were expected to be. It is powerful.

There are many ways of making the comparison, some of which are very detailed, some use comparison at a more aggregate level. The result of this type of analysis is usually significant additional information about cost performance and the potential for improvement.
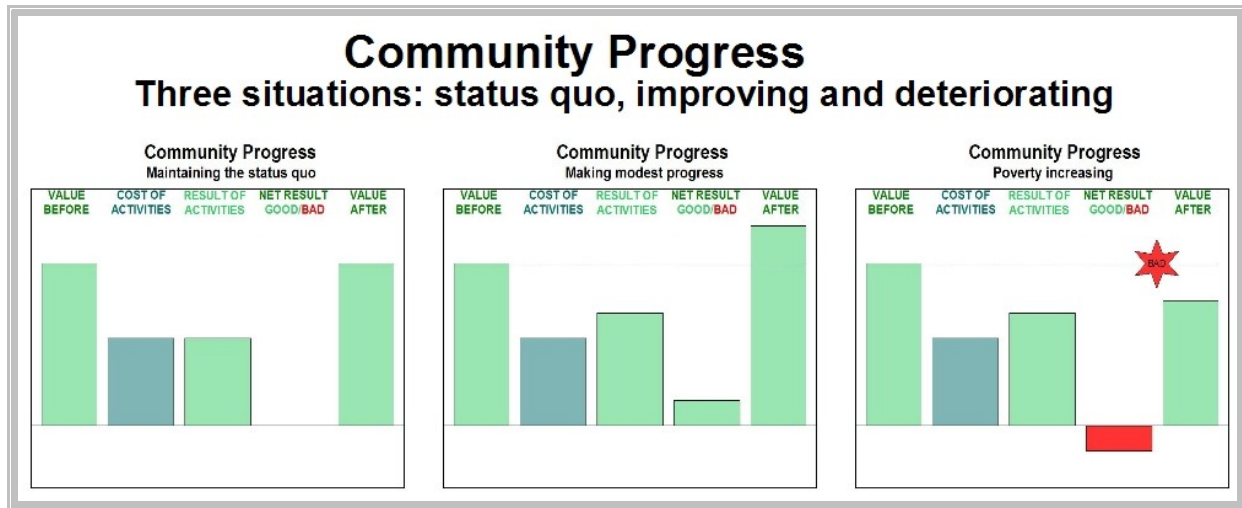
Standards AND activity information

When we use standards ... then it is possible to put activity information into perspective.

Activities – Standard Cost	Activities – Actual Cost
Community Centric Sustainable Development	**Community Centric Sustainable Development**
STATE 1 ACTIVITIES / IMPACT STATE 2	STATE 1 ACTIVITIES / IMPACT STATE 2
Cost of activities Amount of activities this cost should have produced	Cost of activities ... the same Amount of activities this actually produced

The use of standards shows that the amount of activities that should have been produced for the money used ... and this may be compared to the amount of activity actually produced for the money. This does nothing to help assess the impact of the activity, but it does help to ascertain the relative efficiency of doing the activity.

Some simple analysis can be used to determine whether the differences are caused by changes in the unit prices of the inputs ... higher prices for fuel ... higher wages for staff, etc. or whether the cause is a question of productivity with simply less production than was expected from the standard.
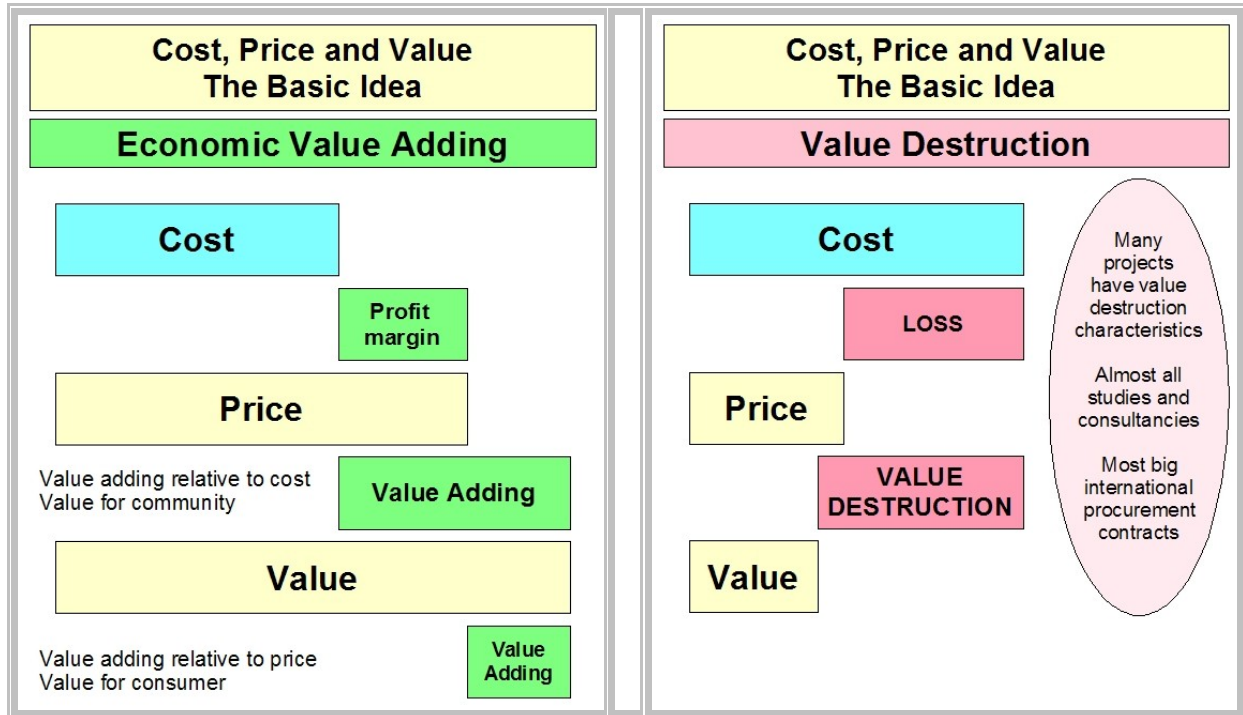
The following graphic how community progress can be represented using changes in community value and the characteristics of activities to show the maintenance of the status quo, improvement or modest progress, and deterioration with poverty increasing.

Community Progress
Three situations: status quo, improving and deteriorating

UNDERSTANDING COST AND VALUE BEHAVIOR

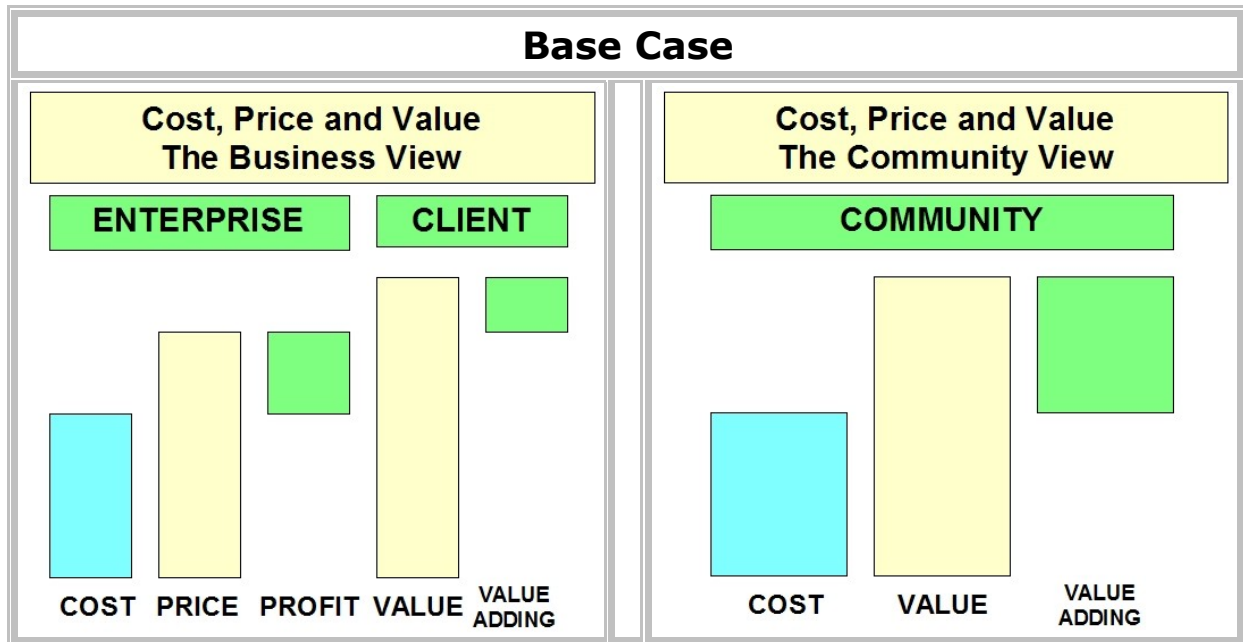## COST, PRICE AND VALUE AND VALUE CHAIN

Price has an important role in the matter of economic incentive ... and the question of sustainability. The value chain works and is efficient when the transfer pricing through the value chain provides a reasonable rate of return on capital employed within each piece of the value chain. If any of the links in the chain become unprofitable, the value chain becomes dysfunctional.

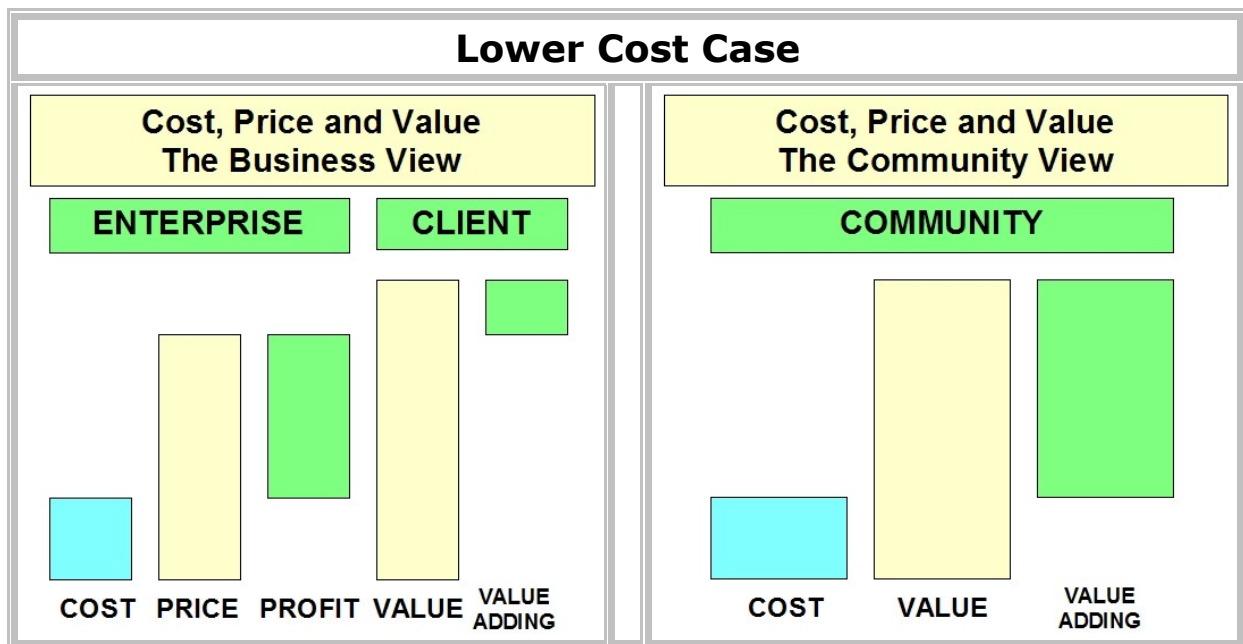| Cost, Price and Value The Basic Idea	Cost, Price and Value The Basic Idea
Economic Value Adding	**Value Destruction**
Cost	**Cost**
Profit margin	LOSS
Price	**Price**
Value adding relative to cost Value for community — Value Adding	VALUE DESTRUCTION
Value	**Value**
Value adding relative to price Value for consumer — Value Adding	Many projects have value destruction characteristics Almost all studies and consultancies Most big international procurement contracts

HOW PRICE IMPACTS COMMUNITY

Price is a key variable in the performance of society. It is not as important as cost, but the way price is used in society determines the way value is shared between the various economic actors. The following graphic shows how an economic transactions that has costs and value is shared between the enterprise and the client depending on the price being applied to the transaction.

For society as a whole the value adding is the difference between the value and the cost. For the client the value adding is what is left of value adding after the enterprise has taken out its profit. In the profit maximizing enterprise the goal is to have profit as much as possible, and the amount left in the hands of the client is of little consequence.

Base Case

Cost, Price and Value
The Business View

ENTERPRISE   CLIENT

COST   PRICE   PROFIT   VALUE   VALUE ADDING

Cost, Price and Value
The Community View

COMMUNITY

COST   VALUE   VALUE ADDING

In a lower cost case the enterprise profit increases at the same price point ... and the amount of value derived by the client stays the same.

Lower Cost Case

Cost, Price and Value
The Business View

ENTERPRISE   CLIENT

COST   PRICE   PROFIT   VALUE   VALUE ADDING

Cost, Price and Value
The Community View

COMMUNITY

COST   VALUE   VALUE ADDING

If the client and the enterprise are in the same community it does not matter so much whether the client or the enterprise has what share of the value added ... but where the enterprise is from outside the community it matters a lot. In the case where the enterprise is external ... the case of Foreign Direct

Investment (FDI) for example ... the value adding for the community is small because the profit leaves the community. If the costs are incurred in the community there is some multiplier effect ... but typically local disbursements are small and most of the costs, as for example in mining are equipment, fuel, expatriate payroll .... with rather little value for the community.

The External Enterprise Case

Cost, Price and Value
The Business View

ENTERPRISE   **CLIENT**

COST   PRICE   PROFIT   VALUE   VALUE ADDING

Cost, Price and Value
The Community View

COMMUNITY

MULTIPLIER

COST   VALUE   VALUE ADDING