

True Cost Accounting – Basics and beyond



CMA (Dr.) S K Gupta

The perspective

True cost accounting is a model that seeks to include the cost of negative externalities into the pricing of goods and services. Supporters of this type of economic system feel products and activities that directly or indirectly cause harmful consequences to living beings and/or the environment should be accordingly taxed to reflect the somewhat hidden costs. True cost accounting is a method of cost accounting that traces direct costs and allocates indirect costs by collecting and presenting information about the possible environmental, social and economical costs and benefits or advantages – in short, about the “triple bottom line” – for each proposed alternative.

Air, water, and land are not the „free goods” our society once believed them to be. They must be redefined as assets so that they can be appropriately and efficiently allocated. Ideally, we would live on their „interest” rather than deplete the assets themselves. As one of many economic instruments proposed to market incentives for environmental management, true cost accounting aims to price goods and services to reflect the true social and environmental costs. An accurate understanding of businesses, governments, and resources must include an estimate of all financial, environmental, and social costs. Many of these costs are not currently counted and are described as “external” costs. That does not, however, make them any less real. When moving from financial to environmental to social costs, challenges increase in determining costs. The data needed for complete true cost reporting is rarely available

True cost accounting – concept

True-cost thinking is actually an extension of true-cost accounting, a method that expands conventional fiscal

considerations of profit and loss to include what might otherwise be easy-to-overlook (but inherently important and potentially very expensive) environmental and social factors (externalities) not included in what the business bases its price on. These include:

- the cost of disposing of the product at the end of its useful life
- the environmental degradation caused by the emissions, pollutants and wastes from production
- the cost of health problems caused by harmful materials and ingredients
- social costs associated with increasing unemployment due to increasing automation

Even though external costs are not included in the price of the product they still have to be paid. Society ends up paying them through taxes, accident compensation, medical payments, insurance payments and also through losses in environmental quality and natural capital. Products and services that include external costs (e.g. organic produce, clean technology, natural products, renewables) are usually more expensive than those that don't. Consumers will tend to buy the cheapest goods so clean products are at a price disadvantage. One way to include external costs is for governments to add a tax directly to those products or activities that have them. The restructuring of taxes, which is often called ‘tax shifting’, would mean that good things Benefits of true cost accounting are not taxed whilst bad things (like pollution) are.

Benefits of true cost accounting

Increasing efforts to improve and refine true cost accounting are already bearing fruit. Many companies have discovered new opportunities to reduce waste,

pollution and pollution control costs, improve process management, and correct internal accounting flaws that have in the past led good products to subsidize bad ones.

True cost accounting has the potential to:

- Improve profitability
- Reduce risk and liability
- Improve employee morale and health
- Lead to better decisionmaking Highlight opportunities for cost savings
- Identify opportunities for new processes
- Uncover opportunities for new products and services
- Add competitive advantage
- Improve stakeholder relations
- Build reputation and branding of the company
- Improve internal and external communication
- Lead to more accurate and complete costing and pricing
- Provide value to the community and society at large

These potential benefits of true cost accounting are encouraging increased commitments to environmental and social accounting within the academic world as well as in traditional financial and management accounting, policy accounting, and environmental management accounting. These potential benefits of true cost accounting are encouraging increased commitments to environmental and social accounting within the academic world as well as in traditional financial and management accounting, policy accounting, and environmental management accounting

True cost accountant

The world tomorrow will find a new corporate function—true cost accountant. He or she will work hand in hand with the financial and sustainability departments to ensure that the organization is maintaining accurate and complete account information. This work will require field and information technology skills as well as traditional accounting training. True cost accounting will also create the need for forensic true cost accountants, certified true cost accountants, and independent true cost accountants for verification and certification of reports. Many of the new jobs in true cost accounting will also be for policy development by NGOs

and governments. When true cost accounting is applied, resource use and adverse impacts can be reduced by 50 percent to 90 percent in most sectors and the comfort and security of citizens will be improved. True cost accounting can help create a healthier, more prosperous, more secure, and less wasteful society.

Moving towards true cost accounting

There is a simple but powerful paradigm shift behind all this. One important aspect involves recognizing that if the methods we're using to create wealth ultimately endanger our ability to continue producing and enjoying that wealth, then those methods are not in our long-term common interest. This is what the term "sustainability" is all about. Unfortunately, it's not a concept that is ingrained in our conventional modes of thinking about economic development and growth – or even about our own well-being.

True cost thinking

True-cost thinking actively considers the positive and negative impacts to ecology and social welfare right alongside conventional, purely fiscal profit-minded concerns. It considers the "three Ps" (planet, people and profit) in an integrated way, recognizing that the only way to responsibly and sustainably do business is to treat these concerns as the interlocking and globally interdependent factors they are. True-cost thinking encourages us to evaluate the return on our investments – as individuals, communities, societies and as a planet – in a more comprehensive and discerning way. It also offers us a way to consider the type of future in which we want to invest not just our fiscal resources, but also our time, energy and collective focus.

There's not yet any single agreed-upon formula for precisely calculating the true costs and long-term impacts of the wide range of goods and services we consume daily. Nor is there any one unified way of expressing those costs on paper. But there does appear to be a growing sense of agreement that it's a good idea to connect our economic decisions to broader social and environmental issues, considering the indirect, hidden and long-term impacts (as well as direct, obvious and short-term impacts) of the paths we choose to pursue.

A key tool in initiating full-cost accounting will be life-cycle analysis (LCA). This process, also in its developmental stages, systematically identifies and describes each step of a product's life, from raw materials to final disposal. Although industry cannot immediately build true cost accounting into its accounting and economic evaluation methods, it certainly can put some tests in place and begin disciplining itself. We can make a start on a four-step process:

- Debate and discuss the concept
- Develop new tools, such as LCA
- Measure and assign environmental costs
- Eventually, price products accordingly

The way forward

There are countless examples where full-cost accounting is working. Nonetheless, if misapplied, it could cause businesses and entire industries to become uncompetitive. It is imperative that we gain experience with full-cost accounting gradually, so that someday it will be built into the price of everything produced and bought. It will take years to accomplish, but when implemented correctly, full-cost accounting will improve environmental performance more than any other action, program, or regulation in place today.



OBITUARY

NIRC of ICAI expresses its sincere condolence on the sad demise of CMA K.L. Jaisingh, Past President of Institute on Saturday 2nd September, 2017. He was the president of Institute during the year 2003-04.

May his soul rest in eternal peace.