PRIMER : Full Cost Analysis Primer Transcript

CHAPTER 1: INTRODUCTION TO BASIC ACCOUNTING CONCEPTS

Today lets explore a new method of accounting--one implemented through a process called Full Cost Analysis. We'll break this process into four parts: Life Cycle Analysis, Designing for the Environment, True Cost Accounting and Integrated Reporting. At its core, this method differs from traditional accounting by including what we typically don't account for: social and environmental costs.

Before we get too far, let's define **Accounting**. Accounting is a system by which businesses collect and aggregate information for decision makers about the performance of the company and its creation of value over time. Traditional accounting has tended to have a fairly limited view of "value," focusing especially on narrow and short-term financial gain for shareholders.

The tools of accounting hold great potential, though. Accounting creates a collective picture of the financial affairs. It allows us to make predictions we wouldn't otherwise be able to make. It does this by putting together the past performance of the organization we know, and putting it alongside trends developed from aggregation of data on a larger level, which is especially helpful for organizations and companies that need to carefully and strategically coordinate limited assets. We can see this on the personal level: you apply lessons you've been given in general, our aggregate trends, often coming on the personal level in the form of phrases like "waste not want not" or "a penny saved is a penny earned," or in examples set by your parents or friends). Then we apply that advice and experience to household accounts by setting budgets, tracking expenses, and thinking prudently.

So this basic Cost Accounting System can be used to do anything from the day-to-day decision-making that is a part of any organization, to the highest level of operational management. The lowest to the highest level. It can also motivate managers to follow goals already laid out by the organization, or it can identity opportunities to add future value. Thus, it deals with both past and future.

We're probably all familiar with the basics of conventional accounting. Organizations do something to generate **revenue** through the sale of products or services, but in doing that you incur **costs**—paying people, transportation, or using utilities and resources. The difference between the revenue generated and the costs results in the organization's **income**, sometimes also referred to as **profit**.

Now lets start breaking down these terms.

Costs come in two broad categories, Direct and Indirect Costs.

Direct costs stem clearly and directly from service rendered or production. For example, project staff salaries, supplies and energy costs.

Indirect costs are just the opposite, and are often referred to as overhead: costs that come as byproducts of the central function of the organization. Think of a university: what is the central job of a university? [Teaching/teachers] So what is primarily the direct cost? [Salaries of teachers/faculty] You might be surprised to know that most universities spend more than half of their budgets on indirect costs: technologies, campus facilities, rent, counseling, food services, administrative staff, and security.

Traditionally within any organization, the operating managements' goals and performance are measured in terms of maximizing revenue, minimizing cost, and thus improving profits—profits that then go into new innovations, improvements, and expansions; or in for-profit organizations, back to shareholders as a return on their original investment. In an organization like a university, we're often just getting more efficient and trying to rely on donations as little as possible. That's a problem both in terms of my paycheck and your wallet!