

Recent Developments in Value Added Accounting- An Overview

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Abstract

In this an attempts that author should focus about the value added account. The first thing "value add" implies is a baseline value. To be successful, a product or service must be of value on its own. It has to be able to stand all by itself. In today's competitive marketplace there may be several companies offering the same product or service with the same baseline value. This is the reason they adopt value-added benefits. Value adds is additional value that your product or service has above the baseline. It's a way of differentiating your company from the pack.

Key words: value add- product- marketplace- differentiating- additional

INTRODUCTION

The sum of the unit profit, the unit depreciation cost, and the unit labor cost is the unit value added. Summing the value added per unit over all units sold is total value added. Total value added is equivalent to revenue less outside purchases of materials and services. Value added is a higher portion of revenue for integrated companies for example on manufacturing companies, and a lower portion of revenue for less integrated companies for instance on retail companies. Total value added is very closely approximated by total labor expense which includes wages, salaries, and benefits plus cash operating profit. Operating profit is defined as operating profit plus depreciation expense, which is operating profit before depreciation. The first component (total labor expense) is a return to labor and the second component (operating profit before depreciation) is a return to capital (including capital goods, land, and other property). In national accounts used in macroeconomics, it refers to the contribution of the factors of production, i.e., capital (e.g., land and capital goods) and labor, to raising the value of a product and corresponds to the incomes received by the owners of these factors. The

national value added is shared between capital and labor (as the factors of production), and this sharing gives rise to issues of distribution. Outside of economics, **value added** refers to extra feature(s) of an item of interest; it may be a product, service, or a person that goes beyond the standard expectations and provide something more, even if the cost is higher to the client or purchaser. Value-added features give competitive edges to companies with otherwise more expensive products. On the next section of this thesis, we will try to cover the main concepts in the overall recent developments in value added accounting, some terminologies related to value added accounting and some historical interpretations about value added accounting.

All consumers look at purchases from a cost/benefit analysis. Does the benefit equal or outweigh the cost? Some of that is subjective. Different consumers have different definitions of benefit. Because of this, it is important to make sure that the value you are adding is considered to be beneficial by your prospects.

How do we figure this out? We should follow these steps:

1. Identify the actual baseline value of our product or service. This is the value our

clients see - not necessarily the value
WE believe exists.

- A) Document the value our perceive.
- B) Ask our clients what value they see.
- C) Conduct market research to assess the general public's view of the baseline value.
2. Consider complementary products or services that we could add to a product we offer as a bonus.
3. Consider non-complementary products or services that we could add.
4. Understand our target market

TERMINOLOGIES RELATED WITH VALUE ADDED ACCOUNTING

VALUE ADDED TAX

Value added tax (VAT) is a tax on sales. It works by being charged on the sale price of new goods and services, whether purchased by intermediate or final consumers. However, intermediate consumers may reclaim VAT paid on their inputs, so that the net VAT is based on the value added by producing this good or service.

VALUE ADDED THEORY

Value-added theory (also known as social strain theory) was first proposed by Neil Smelser and is based on the assumption that certain conditions are needed for the development of a social movement. Smelser saw social movements as side-effects of rapid social change.

Smelser argued that six things were necessary and sufficient for collective behavior to emerge, and that social movement evolves through those relevant stages:

1. Structural conduciveness - the structure of the society (e.g. spatial proximity) must be such that certain protest actions become more likely. People must be aware of the problem and have the opportunity to act.
2. Structural strain - there must be a strain on society, caused by factors related to the structure of the current social system, such as inequality or injustice, and existing power holders are unable

(or unwilling) to address the problem (see also relative deprivation).

3. Generalized belief - the problem should be clearly defined in a way that is agreed by and understood by the participants. See also: framing.
4. Precipitating factors - events that become the proverbial spark igniting the flame, in other words a political opportunity.
5. Mobilization for action - people need to have a network and organization allowing them to take a collective action, see also resource mobilization
6. Operation (failure) of social control - how the authorities react (or don't). High level of social control by those in control of power (politicians, police) often makes it more difficult for social movements to act.

The concept of value added was used earlier in economics, where it refers to the increasing value of product in progressing stages of production.

Critics of this theory note that it is too focused on the structural-functional approach and views all strains on society as disruptive.

VALUE-ADDED ACTIVITY

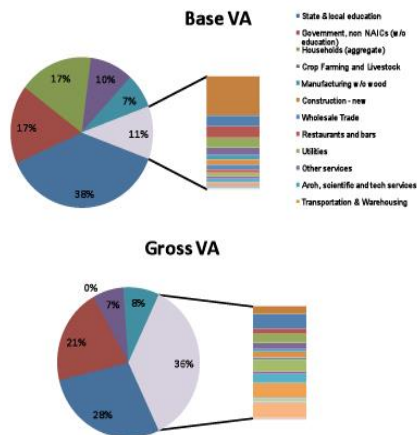
An activity that increases the value of a product at a given stage in a production cycle or supply chain, for example, a timber company cuts down trees, which adds value to the wood because it can then be used. It may then sell the timber to a miller, who adds value by refining the timber into planks of wood. A carpenter who buys the planks adds value by making them into a table, which can then be sold to a customer. The concept of value added is most important in countries and other jurisdictions that have a value-added tax.

GROSS VALUE ADDED

Gross value added (GVA) is a measure in economics of the value of goods and services produced in an area, industry or sector of an economy. In national accounts GVA is output minus intermediate consumption; it is a

balancing item of the national accounts' production account.

Fig. 1- Illustration on gross value added and base value added



Relationship to gross domestic product

GVA is linked as a measurement to gross domestic product (GDP), as both are measures of output. The relationship is defined as:

$$\text{GVA} + \text{taxes on products} - \text{subsidies on products} = \text{GDP}$$

As the total aggregates of taxes on products and subsidies on products are only available at whole economy level, Gross value added is used for measuring gross regional domestic product and other measures of the output of entities smaller than a whole economy. Its formula is as follows:

$$\text{GVA} = \text{GDP} + \text{subsidies} - (\text{direct, sales}) \text{ taxes}$$

Over-simplistically, GVA is the grand total of all revenues, from final sales and (net) subsidies, which are incomes into businesses. Those incomes are then used to cover expenses (wages & salaries, dividends), savings (profits, depreciation), and (indirect) taxes.

Fig. 2-Illustration on Economic value added accounting formulae

EVA - Economic Value Added

- Economic Value Added is a measure of economic profit. It is calculated as the difference between the Net Operating Profit After Tax and the cost of financing the firm's Capital.



SURPLUS VALUE

It is a central concept in Karl Marx's critique of political economy. Marx did not himself invent the term, he developed the concept. "Surplus value" is a translation of the German word "Mehrwert", which simply means value added (sales revenue less the cost of materials used up). Conventionally, value-added is equal to the sum of gross wage income and gross profit income. However, Marx's use of this concept is different, because for Marx, the Mehrwert refers to the yield, profit or return on production capital invested, i.e. the amount of the increase in the value of capital. Hence, Marx's use of Mehrwert has always been translated as "surplus value", distinguishing it from "value-added". According to Marx's theory, surplus value is equal to the new value created by workers in excess of their own labor-cost, which is appropriated by the capitalist as profit when products are sold. Marx thought that the gigantic increase in wealth and population from the 19th century onwards was mainly due to the competitive striving to obtain maximum surplus-value from the employment of labor, resulting in an equally gigantic increase of productivity and capital resources. To the extent that increasingly the economic surplus is convertible into money and expressed in money, the amassment of wealth is possible on a larger

and larger scale (see capital accumulation and surplus product).

VALUE ADDED RATIO

The *value added ratio* (VAR) is the time spent adding value to a product or service, divided by the total time from the receipt of an order to its delivery. A less expansive variation only includes in the denominator the period from the beginning of production or service through delivery. In either case, the VAR is designed to showcase the very large proportion of time and money that a company wastes during its servicing of customers. As such, it is a cost-reduction tool that complements constraint analysis.

VALUE IN MARKETING

It is also known as customer-perceived value, is the difference between a prospective customer's evaluation of the benefits and costs of one product when compared with others. Value may also be expressed as a straightforward relationship between perceived benefits and perceived costs:

Value = Benefits / Cost. The customers get benefits and assume costs. Value is thus subjective (i.e., a function of consumers' estimation) and relational (i.e., both benefits and cost must be positive values). There are cultural expectations and customer expectations involved in it. Let's take an example of well known brand Nike (to understand customer expectations); it comes up with special line of shoes called Air Jordan for the professional NBA players with commercials Michael Jordan doing 'impossible'. In addition Air Jordan releases a limited edition with set amount available for which Nike charges a high amount compared to other products. In the end all the hype about the line of Air Jordan and its limited edition are customer perceived value. To understand cultural expectations lets take an example of Pizzas sold in Japan & United States. The pizza in Japan might be topped with tuna rather than pepperoni, as pizza might be in the United States; the value in the marketplace varies from place to place as well as from market to market.

For a firm to deliver value to its customers, they must consider what is known as the "total market offering." This includes the reputation of the organization, staff representation, product benefits, and technological characteristics as compared to competitors' market offerings and prices. Value can thus be defined as the relationship of a firm's market offerings to those of its competitors.

Value in marketing can be defined by both qualitative and quantitative measures. On the qualitative side, value is the perceived gain composed of individual's emotional, mental and physical condition plus various social, economic, cultural and environmental factors. On the quantitative side, value is the actual gain measured in terms of financial numbers, percentages, and dollars. For an individual to deliver value, one has to grow his or her knowledge and skill sets to showcase benefits delivered in a transaction (e.g., getting paid for a job).

For an organization to deliver value, it has to improve its value: cost ratio. When an organization delivers high value at high price, the perceived value may be low. When it delivers high value at low price, the perceived value may be high. The key to deliver high perceived value is attaching value to each of the individuals or organizations making them believe that what you are offering is beyond expectation helping them to solve a problem, offering a solution, giving results, and making them happy. Value changes based on time, place and people in relation to changing environmental factors. It is a creative energy exchange between people and organizations in our marketplace.

Very often managers conduct customer value analysis to reveal the company's strengths and weaknesses compared to other competitors. the steps of which are as followed.

1. To identify the major attributes and benefits that customers value for choosing a product and vendor.
2. Assessment of the quantitative importance of the different attributes and benefits.

3. Assessment of the company's and competitors' performance on each attribute and benefits.
4. Examining how customer in the particular segment rated company against major competitor on each attribute.
5. Monitor customer perceived value over time.

VALUE ADDED RESELLER

A value-added reseller (VAR) is a company that adds features or services to an existing product, then resells it (usually to end-users) as an integrated product or complete "turn-key" solution. This practice occurs commonly in the electronics industry, where, for example, a VAR might bundle a software application with supplied hardware.

The added value can come from professional services such as integrating, customizing, consulting, training and implementation. The value can also be added by developing a specific application for the product designed for the customer's needs which is then resold as a new package. VARs incorporate platform software into their own software product packages. The term is often used in the computer industry, where a company purchases computer components and builds (for example) a fully operational personal computer system usually customized for a specific task (such as non-linear video editing). By doing this, the company has added value above the cost of the individual computer components. Customers would purchase the system from the reseller if they lacked the time or experience to assemble the system themselves.

VALUE THEORY

Value theory encompasses a range of approaches to understanding how, why and to what degree people value things; whether the thing is a person, idea, object, or anything else. This investigation began in ancient philosophy, where it is called axiology or ethics. Early philosophical investigations sought to understand good and evil and the concept of "the good".

Today much of value theory is scientifically empirical, recording what people do value and attempting to understand why they value it in the context of psychology, sociology, and economics. At the general level, there is a difference between moral and natural goods. Moral goods are those that have to do with the conduct of persons, usually leading to praise or blame. Natural goods, on the other hand, have to do with objects, not persons. For example, the statement "Mary is a good person" represents a very different sense of the word 'good' than the statement "That was some good food".

Ethics is mainly focused on moral goods rather than natural goods, while economics has a concern in what is economically good for the society but not an individual person and is also interested in natural goods. However, both moral and natural goods are equally relevant to goodness and value theory, which is more general in scope.

VALUE CHAIN

A value chain is a chain of activities that a firm operating in a specific industry performs in order to deliver a valuable product or service for the market. The concept comes from business management and was first described and popularized by Michael Porter in his 1985 best-seller, *Competitive Advantage: Creating and Sustaining Superior Performance*. The idea of the value chain is based on the process view of organizations, the idea of seeing a manufacturing (or service) organization as a system, made up of subsystems each with inputs, transformation processes and outputs. Inputs, transformation processes, and outputs involve the acquisition and consumption of resources - money, labor, materials, equipment, buildings, land, administration and management. How value chain activities are carried out determines costs and affects profits.

The concept of value chains as decision support tools, was added onto the competitive strategies paradigm developed by Porter as early as 1979. In Porter's value chains, Inbound Logistics, Operations, Outbound Logistics, Marketing and Sales and Service are categorized as primary

activities. Secondary activities include Procurement, Human Resource management, Technological Development and Infrastructure.

According to the OECD Secretary-General the emergence of global value chains (GVCs) in the late 1990s provided a catalyst for accelerated change in the landscape of international investment and trade, with major, far-reaching consequences on governments as well as enterprises.

VALUE PRODUCT

The value product (VP) is an economic concept formulated by Karl Marx in his critique of political economy during the 1860s, and used in Marxian social accounting theory for capitalist economies. Its annual monetary value is approximately equal to the netted sum of six flows of income generated by production:

1. Wages & salaries of employees.
2. Profit including distributed and undistributed profit.
3. Interest paid by producing enterprises from current gross income
4. Rent paid by producing enterprises from current gross income, including land rents.
5. Tax on the production of new value, including income tax and indirect tax on producers.
6. Fees paid by producing enterprises from current gross income, including: royalties, certain honorariums and corporate officers' fees, various insurance charges, and certain leasing fees incurred in production and paid from current gross income.

The last five money-incomes are components of realized surplus value. In principle, the value product also includes unsold inventories of new outputs. Marx's concept corresponds roughly with the concept of value added in national accounts, with some important differences (see below) and with the proviso that it applies only to the net output of capitalist production, not to the valuation of all production in a society, part

of which may of course not be commercial production at all.

CASH VALUE ADDED

Cash value added (CVA) is a measure of business profitability defined as the EBITDA after tax generated by the business less its required return. The required return is an annuity based on the purchase price of the assets in use in the business, inflated to today's value of money, the weighted average cost of capital (WACC) and the economic life of the assets.

CVA can also be expressed as an index, where the CVA is divided by the required return. An index of more than 1.0 will indicate profitability while an index below 1.0 will indicate value destruction.

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expressed in money, the amassment of wealth is possible on a larger and larger scale.

VALUE ADDED STATEMENT

It is a financial statement which shows how much value (wealth) has been created by an enterprise through utilization of its capacity, capital, manpower, and other resources, and how it is allocated among different stakeholders (employees, lenders, shareholders, government, etc.) in an accounting period.

DEPRIVAL VALUE

It is a concept used in accounting theory to determine the appropriate measurement basis for assets. It is an alternative to historical cost and fair value or mark to market accounting. Some writers prefer terms such as 'value to the owner' or 'value to the firm'. Deprival value is also sometimes advocated for liabilities, in which case another term such as 'Relief value' may be used. The deprival value of an asset is the extent to which the entity is "better off" because it holds the asset. This may be thought of as the answer to the following questions, all of which are equivalent: - What amount would just compensate the entity for the loss of the asset? - What loss would the entity sustain if deprived of the asset? - How much would the entity rationally pay to acquire the asset (if it did not already hold it)?

Deprival value is based on the premise that the value of an asset is equivalent to the loss that the owner of an asset would sustain if deprived of that asset. It builds on the insight that often the owner of an asset can use an asset to derive greater value than that which would be obtained from an immediate sale. For example, a machine may be profitably employed in a business but no more than scrap value could be obtained from its sale (net selling price). Deprival value reasons that the maximum value at which an asset should be stated is its replacement cost as, by definition, the owner can make good the loss arising from deprival by incurring a cost equivalent to replacement cost. However, if that amount is greater than the amount that can be derived from ownership of

the asset, it should be valued at no more than its recoverable amount. Recoverable amount is, in turn, defined as the higher of net selling price and value in use, which is the present value of the future returns that will be made by continuing to use the asset.

1. Deprival value equals the lower of replacement cost and recoverable amount; and
2. Recoverable amount is the higher of net selling price and value in use.

An important practical implication of deprival value reasoning is that many assets will be stated at replacement cost, as entities tend to hold and use assets that they can employ profitably and dispose of those that they cannot.

CRITICISMS OF DEPRIVAL VALUE

Critics of deprival value assert that it is more complex than other measurement bases. Its use may also give rise to values that differ significantly from market values. Comparison between the values of assets owned by different entities may be difficult where deprival value is used because it reflects the position of the reporting entity. Critics also point out that the calculation of value in use is difficult and may be subjective.

HISTORY AND CURRENT DEVELOPMENTS

The origin of deprival value is frequently ascribed to JC Bonbright's 1937 work *The Valuation of Property*. Edwards and Bell's *The Theory and Measurement of Business Income* (1961) were hugely influential in emphasizing the difference between entry and exit values and making the case for replacement cost. Articles by David Solomon and Parker and Harcourt influenced a generation of accounting scholars. In his 1975 work, WT Baxter seems to have been the first to use the term 'deprival value'.

During the 1970s deprival value played a major role in the development of accounting in times of inflation, being endorsed by official reports in the UK, Australia, New Zealand, and Canada. Deprival value also formed the basis of the

disclosures required in the United States by SFAS 33. Although the extent to which deprival value contributed to the failure of attempts to introduce inflation accounting is debatable there is no doubt that interest in deprival value subsequently declined. It was, however, endorsed in 1999 by the UK Accounting Standards Board in its Statement of Principles for Financial Reporting and has featured in recent collections of articles on accounting measurement. Most recently, the International Public Sector Accounting Standards Board has discussed deprival value (and its application to liabilities under the 'relief value' model) in a Consultation Paper issued as part of its project to develop a Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities.

MARKET VALUE ADDED

The market value added concept derives the difference between the market value of a business and the cost of the capital invested in it. When market value is less than the cost of invested capital, this implies that management has not done a good job of creating value with the equity made available to it by investors.

To derive market value added, we should follow these steps:

1. Multiply the total of all common shares outstanding by their market price
2. Multiply the total of all preferred shares outstanding by their market price
3. Combine these totals
4. Subtract the amount of capital invested in the business

The formula is:

$(\text{Number of common shares outstanding} \times \text{share price}) + (\text{Number of preferred shares outstanding} \times \text{share price}) - \text{Book value of invested capital}$

As an example, the investor relations officer of Cud Farms is preparing a press release that reveals the increase in market value added since the new management team was hired. The analysis is based on the following information:

	Prior Year	Current Year

Number of common shares outstanding	5,000,000	5,700,000
Common stock price	\$4.00	\$4.20
Number of preferred shares outstanding	400,000	375,000
Preferred share price	\$11.00	\$11.30
Book value of invested capital	\$18,000,000	\$20,625,000

The market value added for the prior year is calculated as follows:

$(5,000,000 \text{ Common shares} \times \$4.00 \text{ price}) + (400,000 \text{ Preferred shares} \times \$11.00 \text{ price}) - \$18,000,000 \text{ Equity book value} = \$6,400,000 \text{ Market value added}$

The market value added for the current year is calculated as follows::

$(5,700,000 \text{ Common shares} \times \$4.20 \text{ price}) + (375,000 \text{ Preferred shares} \times \$11.30 \text{ price}) - \$20,625,000 \text{ Equity book value} = \$7,552,500 \text{ Market value added}$

Based on this analysis, the investor relations officer can highlight an increase of \$1,152,500 in market value added since the new management team was hired.

This measurement should only be used if a company's stock is robustly traded on an established stock exchange. Otherwise, a few occasional trades in the over-the-counter market could trigger substantial changes in the market price of the stock. It may be possible to derive the market value of shares by engaging an appraiser to provide an estimate, especially if a company is privately-held.

Also, be aware that the current stock price may be based on changes in investor confidence in

the market or industry as a whole, and do not relate to the performance (or lack thereof) of management in running a business.

LABOR THEORY OF VALUE

It is a heterodox economic theory of value that argues that the economic value of a good or service is determined by the total amount of labor required to produce it. At present this concept is usually associated with Marxian economics, although it is also used in the theories of earlier classical economists such as Adam Smith and David Ricardo and later also in anarchist economics.

When speaking in terms of a labor theory of value, value, without any qualifying adjective should theoretically refer to the amount of labor necessary to the production of a marketable commodity, including the labor necessary to the development of any real capital employed in the production. Both David Ricardo and Karl Marx attempted to quantify and embody all labor components in order to develop a theory of the real price, or natural price of a commodity. The labor theory of value, as presented by Adam Smith, however, did not require the quantification of all past labor, nor did it deal with the labor needed to create the tools (capital) that might be employed in the production of a commodity. The Smith theory of value was very similar to the later utility theories in that Smith proclaimed that a commodity was worth whatever labor it would command in others (value in trade) or whatever labor it would "save" the self (value in use), or both. But this "value" is subject to supply and demand at a particular time.

The real price of everything, what everything really costs to the man who wants to acquire it, is the toil and trouble of acquiring it. What everything is really worth to the man who has acquired it, and who wants to dispose of it or exchange it for something else, is the toil and trouble which it can save to himself, and which it can impose upon other people.

Smith's theory of price (which for many is the same as value) has nothing to do with the past labor spent in the production of a commodity. It

speaks only of the labor that can be "commanded" or "saved" at present. If there is no use for a buggy whip then the item is economically worthless in trade or in use, regardless of all the labor spent in its creation.

REAL VS. NOMINAL VALUE IN ECONOMIC ACCOUNTING

In economics a nominal value is an economic value expressed in historical nominal monetary terms. By contrast, a real value is a value that has been adjusted from a nominal value to remove the effects of general price level changes over time and is thus measured in terms of the general price level in some reference year (the base year). For example, changes in the nominal value of some commodity bundle over time can happen because of a change in the quantities in the bundle or their associated prices, whereas changes in real values reflect only changes in quantities. The process of converting from nominal to real terms is known as inflation adjustment.

Real values are a measure of purchasing power net of any price changes over time. For example, nominal income is often restated as real income, thus removing that part of income changes that merely reflect inflation (a general increase in prices). Similarly, for aggregate measures of output, such as gross domestic product (GDP), the nominal amount reflects production quantities and prices in that time period, whereas the differences between real amounts in different time periods reflect only changes in quantities. A series of real values over time, such as for real GDP, measures quantities over time expressed in prices of one year, called the base year (or more generally the base period). Real values in different years then express values of the bundles as if prices had been constant for all the years, with any differences due to differences in underlying quantities.

The nominal/real value distinction can apply not only to time-series data, as above, but also to cross-section data varying by region.

For example,

The total sales value of a particular good produced in a particular region of a country is

influenced by both the physical amount sold and the selling price, which may be different from that of the country as a whole; for purposes of comparing the economic activity of different regions, the nominal output of the good in that region can be adjusted into real terms by repricing the goods at national-average prices.

COST-OF-PRODUCTION THEORY

In accounting, the cost-of-production theory of value is the theory that the price of an object or condition is determined by the sum of the cost of the resources that went into making it. The cost can comprise any of the factors of production (including labor, capital, or land) and taxation. The theory makes the most sense under assumptions of constant returns to scale and the existence of just one non-produced factor of production. These are the assumptions of the so-called non-substitution theorem. Under these assumptions, the long-run price of a commodity is equal to the sum of the cost of the inputs into that commodity, including interest charges.

PROCESS IMPROVEMENT

In a process improvement perspective, in order for a step in any process to be considered value added, the activity must meet all three of the following criteria:

- 1) The customer is willing to pay for this activity,
- 2) It must be done right the first time,
- 3) The action must change the product or service in some manner.

NATIONAL ACCOUNTS

The factors of production provide "services" which raise the unit price of a specific product relative to the cost per unit of intermediate goods used up in the production of that product. In national accounts such as the United Nations System of National Accounts (UNSNA) or the United States National Income and Product Accounts (NIPA), gross value added is obtained by deducting intermediate consumption from gross output. Thus gross value added is equal to net output. Net value added is obtained by deducting consumption of fixed capital (or

depreciation charges) from gross value added. Net value added therefore equals gross wages, pre-tax profits net of depreciation, and indirect taxes less subsidies.

MARXIST INTERPRETATION OF VALUE ADDED

Karl Marx's concept of the value product is similar to the national accounting concept of net national product, or net value added, since it is the value of the gross product minus expenditure on constant capital, where the latter refers to the costs of intermediate products and depreciation. In turn, value added is equal to the sum of variable capital (labor's compensation) and surplus-value (pre-tax profit income). The argument is that labor creates a new value (value added) that covers the cost of both its own wages (payment for workers' ability to do labor, i.e. for their labor power) and surplus-value (property income). In Marx's example in his *Das Kapital*, workers exert enough labor-time during a working day to pay for the cost of reproducing their ability to work during that day (their labor-power) and then did extra work (surplus-labor) to pay incomes to capitalists, land-owners, and the like. As labor is the active and conscious factor in the production process, capital goods ("means of production") and gifts from nature ("land," natural resources) only *facilitate* labor's transformation of raw materials into other products, raising labor's physical productivity (its ability to produce use-values) and its value-productivity (its ability to produce use-values that can be sold for money). In contrast, neoclassical economics regards the incomes constituting added value as the *reward* for services rendered. In his critique of political economy, Marx saw incomes as results of production under conditions of capitalist exploitation. The capitalist class control over the production process and the growth of the economy (capital accumulation) gives them the power to claim the benefits of the extra labor done by the workforce. This is enforced by the normal existence of mass unemployment, what Marx called the "reserve army of labor."

DIFFERENCES BETWEEN MARXIST AND NEOCLASSICAL ACCOUNTING OF VALUE ADDED

A difference between Marxist theory and conventional national accounts concerns the interpretation of the distinction between *new* value created, transfers of value and *conserved* value, and of the definition of "production". For example, Rohit Gupta theory regards the "imputed rental value of owner-occupied housing" which is included in GDP as a fictitious entry; if the housing is owner-occupied, this housing cannot also yield real income from its market-based rental value at the same time. In the 1993 manual of the United Nations System of National Accounts (UNSNA), the concept of "imputed rental value of owner occupied housing" is explained as follows: "6.89. Heads of household who own the dwellings which the households occupy are formally treated as owners of unincorporated enterprises that produce housing services consumed by those same households. As well-organized markets for rented housing exist in most countries, the output of own-account housing services can be valued using the prices of the same kinds of services sold on the market in line with the general valuation rules adopted for goods or services produced on own account. In other words, the output of the housing services produced by owner-occupiers is valued at the estimated rental that a tenant would pay for the same accommodation, taking into account factors such as location, neighborhood amenities, etc. as well as the size and quality of the dwelling itself. The same figure is recorded under household final consumption expenditures."

Marxist economists object to this accounting procedure on the ground that the monetary imputation made refers to a flow of income which does not exist, because most home owners do not rent out their homes if they are living in them. Another important difference concerns the treatment of property rents, land rents and real estate rents. In the Marxian interpretation, many of these rents, insofar as they are paid out of the sales of current output of production, constitute part of the new value created and part of the real

cost structure of production. They should therefore be included in the valuation of the net product. This contrasts with the conventional national accounting procedure, where many property rents are excluded from new value-added and net product on the ground that they do not reflect a productive contribution.

WHY COMPANIES USE VALUE-ADDED?

There are two major reasons why companies use value-added accounting:

- (1) The inadequacies that multinational corporations find with GAAP accounting and
- (2) The desire for a system that reflects success (or failure) in achieving the corporate strategy in terms of return on capital invested.

EFFECTS OF VALUE-ADDED ACCOUNTING IN AN INTERNATIONAL CONTEXT

If the hurdle rate is greater than the surplus earnings rate, the value added will increase more rapidly in future years; if the surplus is invested in new business than if it is invested in bonds or whatever the surplus assets may be. We should move on to some of the key late and recent issues which arise in the international context due to value added accounting.

PROFIT ACCOUNTING BASIS

Profits discounted in developing value-added numbers are typically statutory basis profits that are adjusted to reflect statutory capital requirements. The underlying philosophy is that the stream of profits discounted in determining the value added should be directly related to the measure which is used in determining corporate dividends, which is usually some adjusted statutory measure. One nice aspect of the value-added approach is that if the calculation is based on the appropriate accounting basis in each country, the values developed will be comparable for management purposes. The situation differs somewhat depending on whether a branch or a subsidiary operation is involved. The situation for a branch operation may be confused by the fact that the income of the branch is often reported in the parent company

financials on a different basis than it would be reported in the country of operation. For example, some of the U.S. companies operating in Japan feel that reserves on the Japanese block must be reported in the U.S. on a U.S. basis. This may not really make actual sense, but the companies feel that there is a regulatory constraint to do so. In this case, we should discount U.S. basis or Japanese basis income in determining value-added, or perhaps the lesser of the two if we are being conservatives.

REPATRIATION OF PROFITS

It means return of former profit. Suppose dividends payable within a country are tied to the statutory basis, but there are further restrictions on paying funds back to a foreign parent, should this constraint affect our determination of value? If profits can be reinvested in new business with a return at least equal to the hurdle rate, it may still be appropriate to relate value to statutory profits, even if in the short term it is really not clear how long it is going to take to get our hands on the profits. Discussion of this type of issue with management is extremely useful because it really requires that management goals, with respect to our international operation, there for we should be very clearly defined. In general, international operations tend to require longer term horizons in value added accounting than local ones, and if there's too strong of a bias towards equating value with a near-to mid-term cash type return, we may get the wrong answer.

In today's world, value added accounting is used in most acquisitions and disposal works. And they are getting reviewed whether to use it more in assumptions generally in management of business as a whole. But, It is a little bit cautious and care needing issue because there may be some impact of changes. Value added is a more uniform methodology or approach that works pretty well for all share holder-owned businesses. It gives some doubts on the life fund business and the participating businesses, because we usually use a different source of capital and a different effect from expense over runs. Which means we have got much more

opportunity to add up different operations in different countries.

There is no free lunch in this world. To generate income or to earn money, one has to sell some sort of product. A product is a tangible thing or an intangible service having some utility for the buyer. Hence, the product is a utility or value created over the crude material. Value added, therefore, is a created utility in the product of the business. Without creating value, one cannot sell the product for a profitable price. A firm charges some extra price over the materials and services used for the value creation over the product.

For example: If one buys some materials and services at \$ 100 and sells them at \$ 300, then the added value is \$200. Therefore, Net value = Revenues - The price paid for materials and services. Value does not come by itself. It needs some changes over the bought-in materials. Change in the utility of product is brought about by labor, capital, government services etc. Therefore, the added value is to be distributed to the stakeholders of business in the ratio of the service rendered by each of the stakeholders. Added value is paid in the form of wages and salaries to labor, taxes and duties to government, interest and dividends on the capital and residual fund is retained in the business. Therefore, the value added is the increase in the market value created by a change in the form, location or availability of product or service, excluding the cost of bought-in materials or services used in that product or service. Due to the fact that all the created wealth is also allocated in some way the value added can also be computed by the so-called additive method which represents the sum of allocated (distributed) parts of the created wealth. Those parts represent primarily the remuneration of the productive factors which have led to the wealth creation. So, for example, in relation to a company the additive method of value added calculation is shown as follows:

$$VA = RE + RG + RCP + NAP$$

Where:

RE = Remuneration of employees;

RG = Remuneration of government;
RCP = Remuneration of capital providers;
NAP = not appropriated income (retained earnings).

The increase to the value of a product at each stage in a production cycle or supply chain. For example, a timber company cuts down trees, which adds value to the wood because it can then be used. It may then sell the timber to a miller, who adds value by refining the timber into planks of wood. A carpenter who buys the planks adds value by making them into a table, which can then be sold to a customer. The concept of value added is most important in countries and other jurisdictions that have a value-added tax.

CONCLUSION

Value does not come by itself. It needs some changes over the bought-in materials. Change in the utility of product is brought about by labor, capital, government services etc. Therefore, the added value is to be distributed to the stakeholders of business in the ratio of the service rendered by each of the stakeholders. Added value is paid in the form of wages and salaries to labor, taxes and duties to government, interest and dividends on the capital and residual fund is retained in the business. Therefore, the value added is the increase in the market value created by a change in the form, location or availability of product or service, excluding the cost of bought-in materials or services used in that product or service. Value added is a more uniform methodology or approach that works pretty well for all share holder-owned businesses. It gives some doubts on the life fund business and the participating businesses, because we usually use a different source of capital and a different effect from expense over runs. Which means we have got much more opportunity to add up different operations in different countries.

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