

How to Talk to Accounting about Lean*

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* Version 3

Version 1

- ⦿ Talk about overhead and overhead allocation
- ⦿ Talk about Activity Based Costing
- ⦿ Talk specifics about what to measure and how

- ⦿ I'm not an accountant
- ⦿ I can't expect to make you all accountants in one hour
- ⦿ It would be boring



Version 2

- ◉ Define Lean
 - ◉ Discuss how it changes things
 - ◉ Sell it
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- ◉ You already know what lean is
 - ◉ This wouldn't help you with accounting
 - ◉ See version 2, bullet 3



How to talk to accounting about Lean v3.0

- ◎ The Lean view of the world
- ◎ How accounting should view Lean
 - > 6 points

Lean

- ◎ Focused on reducing waste
 - > Waste includes inventory, time, effort, handling, movement, etc.
 - > Looks at productivity, efficiency differently
- ◎ Is process oriented
 - > Always tied to customer value
- ◎ Wants to eliminate reporting
 - > Does not contribute to customer value

Accounting Orientation

- Accountants want to pool non-direct costs and apply them on labor

100 years ago

Material	50%
Labor	40%
Overhead	10%
OH Rate	25% of labor



Today

Material	40%
Labor	15%
Overhead	45%
OH Rate	300% of labor

- What happens when you reduce labor content through Lean?

Accounting Orientation

MBA Programs teach students:

if we produce more than the customer wants, we are allowed to "defer" the costs of those products we do not sell to the Balance Sheet as assets – making ourselves look really good this month.

Toyota's True North metrics:

- ◎ Q – Quality Improvement
- ◎ C – Cost / Productivity Improvement
- ◎ D – Delivery / Lead Time / Flow Improvement
- ◎ H – Human Development

Cost of Quality

- ⦿ Internal failures – scrap and rework.
- ⦿ External failures – warranty costs, cost of complaints and returns.
- ⦿ Appraisal failures – cost of inspection and quality audits.
- ⦿ Prevention failures – "process" control and training.

Fact: significant quality-related costs are NOT captured by most accounting systems

Cost of Quality

- ◎ Another internal failure: increased cycle time, which leads to higher Inventory.
- ◎ The only way this becomes "visible" is if we use a VSM (Value Stream Map) to guide our continuous improvement and vision for our business.

Delivery

Little's Law:

LEAD TIME =

WIP / AVERAGE COMPLETION RATE.

To reduce lead time, either decrease WIP
or increase completion rate

How does accounting view this?

Productivity

Productivity =

Revenues / number of Employees

To increase productivity, increase revenue
or decrease number of employees

Lean Companies

- ◎ Cut waste (not cost)
- ◎ Increase productivity by raising revenues not cutting payroll
- ◎ Increase revenues by growing business, not by raising prices.
- ◎ Understand COQ and Six Sigma
- ◎ Use Lean for speed to market, and Six Sigma for quality.
- ◎ Use Value Stream maps to measure and guide
- ◎ Engage in a permanent culture change, which means changing the management system

Lean Accounting

- ◎ Performance measurements that motivate lean actions - at the cell level, the value stream level, and at the plant or corporation level.

Lean Accounting (point 1)

- ⦿ Eliminate transactions through the elimination of the need for them.
- ⦿ Lean companies bring processes under control and eliminate the need for the cost accounting, inventory control, etc.
- ⦿ Lean performance measurements (think value stream) become the primary control manager.

Lean Accounting (Point 2)

- ① Lean manufacturing does not cut costs; it turns waste into available capacity.
- ② The financial impact comes as you make decisions on how to use this capacity (and the cash flow from reduced inventory).
- ③ Lean Accounting uses specific tools for understanding the impact of lean changes on the company financially.

Lean Accounting (Point 3)

- ⦿ Replace standard costing with costing of the value stream.
- ⦿ A Lean shop is less like a job shop and more like a process manufacturer.
- ⦿ Process inherently has less reporting.
- ⦿ Value Stream measurements provide more valid information.

Lean Accounting (Point 4)

- ◎ Value stream profitability and contribution margin support pricing, profitability, make/buy, new product introduction, product and customer rationalization, etc.
- ◎ Similar to throughput accounting
 - > Requires an understanding of flow through the bottleneck (or constraint) within the value stream.
 - > “Value stream cost analysis” is one method

Lean Accounting (Point 5)

- ⦿ The goal: Drive the business from customer value (not cost).
- ⦿ Understand of how we create value for the customer
- ⦿ Understand where costs are in the value stream
- ⦿ Compare where value is created with where costs occur; initiate kaizens (and the like) to bring value and cost into line.
 - > The best way to reduce effective cost is, of course, to increase sales.

Lean Accounting (Point 6)

- ⦿ Implementing Lean Accounting requires a maturity path.
- ⦿ It is only as processes are brought under control through lean thinking that we can - step-by-step - dismantle the wasteful, misleading, and actively harmful traditional accounting systems.
- ⦿ Timing is important. You need to address Lean Accounting when people recognize a problem with the old accounting.

The Key

◎ Education

- > Capture their (accounting's) interest
- > Help them understand what Lean is
- > Help them find resources for Lean accounting techniques and processes

Credits, More information:

- ◎ Most of the information presented can be found on the Internet
 - > Search: “Lean accounting”
 - Maskell.com/lean_accounting
 - Journal of accountancy
 - Wikipedia

Thank you
for coming tonight

October: Plant tour – Foss Manufacturing

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