

ACCOUNTING FOR LEAN TASTES

Manufacturers are showing growing support for lean accounting, which proponents say more accurately reflects activities of a lean organization.

> BY JILL JUSKO

There has been a “quiet revolution” unfolding the past few years among lean manufacturers, centered on the idea that traditional accounting measures don’t accurately reflect the true results that lean delivers—to the point that they sometimes promote the very opposite of lean. In fact, according to Brian Maskell, president of consulting firm BMA Inc., “Traditional accounting systems are actively harmful to lean organizations,” necessitating an overhaul of the entire process in favor of lean account-



Down By The Oil' Value Stream

Consultant Brian Maskell, president of BMA Inc., recommends value stream costing as a replacement for standard costing, largely because it's a "simpler, more accurate, lean-focused method."

For value stream costing to be effective, however, the following must be in place at a manufacturing company:

- Reporting by value stream, not by department. A value stream, basically, includes all the processes that create value for a customer.
- People should be assigned to a single value stream with little or no overlap.
- There should be few shared services departments, and little requirement for cost allocation.
- Production processes must be largely under control so that variability is reasonably low.
- Thorough tracking of "out-of-control" situations and exceptions, such as scrap and rework.
- Inventory must be under control, relatively low and consistent.

Maskell's IW '07 Best Plants Conference presentation, "Lean Accounting: Solving the Standard Costing Problem," is available at www.iwbestplants.com.

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ing. Current signs indicate that the lean accounting movement is finding traction within the lean community.

There is no definitive measure to know how many manufacturers are employing lean accounting in their enterprises. However, anecdotal evidence exists that suggests interest in lean accounting is growing. For example, the Lean Accounting Summit, an annual event now in its third year, drew some 320 attendees when it launched in 2005. That grew to 520 in 2006, and according to its organizers this year the summit is expected to draw 700 for the late September event.

"The momentum on learning about lean accounting continues to grow, which makes sense," says Jean Cunningham, who heads her own consulting firm. She also is the former CFO at both Marshfield Door Systems and Lantech Inc. At the latter Cunningham was actively involved in taking lean from the manufacturing floor to the business offices. "As lean continues to be driven at the shop floor, the accountants and leadership are curious and thirsting for breakthroughs in understanding the financial results and activities of the business."

Beyond interest in lean accounting, however, is implementation. According to Jerry Solomon, vice president of operations—Hunt Valley for packaging equipment manufacturer

MarquipWardUnited, and a lean accounting instructor, "More and more of the attendees to my classes are in the midst of implementation, whereas a few years ago the attendees were just 'kicking the tires.'"

Manufacturers such as Parker Hannifin, Ariens, Buck Knives and Textron are other manufacturers serious about lean accounting. That's only likely to spur more converts.

Born Of Frustration

The interest in lean accounting is a byproduct of interest in the entire lean movement. In a nutshell, lean seeks to improve business by focusing on what the customer wants, eliminating steps and processes (waste) that do not contribute value to the customer, and utilizing the talents of the entire workforce to continuously improve.

"Lean accounting is part of this [lean movement], just like all the other tools we deploy to help us achieve a continually improving business," says Cunningham. "Hard-to-understand financial reports, measurements that drive us to make wasteful decisions, cumbersome accounting operations and corporate ivory towers are all barriers to a lean organization. We, in finance and accounting, must do our part to strive to live lean."

That means more than simply applying lean principles to the

accounting function. That means using accounting methods that actively support lean and show—clearly and simply—how lean changes in managing operations impact operational and financial performance. And, of course, provide value to the customer.

That's something traditional accounting simply does not do, lean accounting proponents say. In fact, they argue, it encourages high-volume, traditional batch-and-queue manufacturing. For example, traditional accounting promotes the buildup of inventory by identifying it as an asset. This runs completely counter to lean, which calls for keeping inventory levels as low as possible. As a result, good lean practices may show up on financials inaccurately as poor performance, using traditional accounting methods.

In addition, traditional accounting reports can be terrifically difficult for anyone to understand, a scary thought given the importance of the decisions they may drive.

Lean accounting calls for using real numbers that everyone can understand and act upon, says BMA's Maskell, an authority on the topic of lean and lean accounting. Costs are charged to value streams, and are attached to real people, real machines, real materials and real support services. Allocations are eliminated or at least greatly reduced (see sidebar, "Down by the Ol' Value Stream").

Better information leads to better decision-making, he says. "It would be wrong for me to say that lean accounting will increase the sales of your business, because that's not really true. Lean accounting in itself will not do that. But most companies we work with find that they make better decisions as a result of the information they get from lean accounting." Better decisions, he points out, should result in higher revenues, business growth and improved profitability—"all the things we're looking to do."

Barriers Remain

Recent survey results released by the Lean Enterprise Institute show that obstacles to adoption of lean production continue to exist, with the main obstacles being middle management resistance, lack of implementation know-how, and employee and supervisor resistance. To a lesser extent, lack of recognition of lean's financial value is another obstacle.

In some respects the challenges that slow implemen-

tation of lean also inhibit the adoption of lean accounting. Business' attachment to current standard cost accounting practices is a huge obstacle to lean accounting adoption, concedes Solomon. Other barriers he hears include: "our auditors won't let us use lean accounting," "lean accounting doesn't comply with generally accepted accounting principles (GAAP)" ("not true," lean accounting proponents say), "corporate won't let us," and "lean is just for manufacturing."


What those reasons boil down to, however, is resistance to change rather than legitimate barriers, Solomon asserts. "We all know change is difficult, and if left on our own we would not change very much," he says. "Regardless of what we call it, any functional area, whether it is accounting, engineering, purchasing, or whatever, will have its litany of reasons why any potential changes will not work. And it is doubly difficult when the impetus for change is coming from folks outside the functional area."

Adding to the challenge is the fact that the accounting function does have external reporting requirements.

Cunningham suggests that manufacturers consider launching continuous improvement events in the accounting operations, particularly in accounts payable and payroll, even as lean initiatives are launched on the shop floor. The goal: Positive results will generate excitement for other changes, which may be more difficult.

She also believes that it is imperative for a company's CFO, purchasing organization and human resources department to be involved at the start of a lean launch. That doesn't mean they must be involved in the actual implementation, but they ought to be aware that the undertaking is occurring, she says.

While interest is high, lean accounting remains a work in process. "Lean accounting is not an exact science at this point," says Cunningham, "At this point we're all finding our way and finding new methodologies that work for our companies."

Adds Solomon, "We are not suggesting accounting move from traditional costing methodologies with their associated metrics for the sake of change. We are advocating that if a firm is trying to become a world-class organization by deploying lean methodologies and a lean culture, then accounting must be part of that transformation." 



Jean Cunningham co-authored “Real Numbers: Management Accounting in Lean Organization” with Orry Fiume the lead instructor of the Lean Management Accounting course at the TBM LeanSigma® Institute. The book offers a roadmap for bringing lean into the accounting department and other administrative functions. “Real Numbers” was the winner of the 2004 Shingo Prize Award.

Companies throughout the world are using lean principles to dramatically change the competitive landscape while generating new profitability and market share. As these companies transform, however, financial executives are usually not prepared for how lean principles affect finance and do not know how to streamline accounting. The Management accounting model illustrated in “Real Numbers” points the way to unlocking the true profit potential of lean.

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