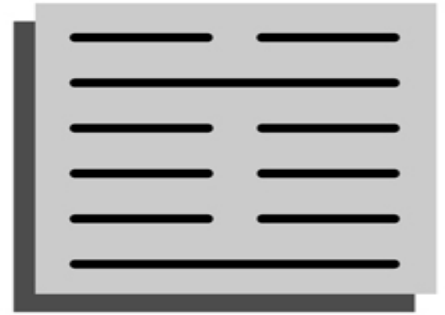


Change Management Associates



September 2012

Featured Topic



By the Numbers

Reflections from the 2012 Lean Accounting Summit

Dear Drew,

Last week I participated in the 8th annual Lean Accounting Summit held this year in Orlando Florida. It is an annual gathering of not only finance and accounting professionals, but people from other functions such as operations and continuous improvement. Attendees were from around the globe, all there to learn and to better understand how accounting practices, processes and performance measures support or conflict with Lean. Listening to the various speakers made me think about my personal 'journey' in this very important subject.

Back in 1986 or thereabouts I was participating in a management program at GE. I read an article in the paper about the fact that GE was not 'profitable' that year, and hadn't been and would not be for several consecutive years. As a young engineer with no experience in the world of accounting, I found this interesting. In particular because I knew that as a company GE had a very strong and positive cash flow during this same time. Cash flow I certainly understood from my life experiences to date, but as I would come to learn I still did not understand 'profitability'. The question I had was 'How can a company have strong cash flow but not be 'profitable'?' Fortunately I had access to people in the company who could answer this question for me. It was my first lesson in 'Lean Accounting'. I won't get into the details of non-cash expenses and the like, let's just summarize the lesson as 'if it doesn't jingle, it doesn't count'. At that time, GE's main performance drivers were market share (be #1 or #2) and cash flow from operations. Now I understood the reason for the latter.

Upcoming Events



CMA and our network affiliates have the following events scheduled:

AME Events:

TPM 101 Event

Collegeville, PA

December 17-18, 2012

Hosted by Superior Tube, this application based event will allow participants to learn in a hands-on way the important subject of Total Productive Maintenance (TPM). Much more than preventive maintenance techniques, TPM also includes autonomous, predictive and productive maintenance concepts. For more information [click here](#)

Mid-Atlantic Lean Conference

Timonium, MD

November 5 - 9, 2012

Hosted by the MD World Class

My next lesson came soon after in the same division. It came to my attention that many parts that were once fabricated 'in-house' had been 'outsourced'. What remained was a single shift machining operation that had millions of dollars of highly capable machines sitting idle each night. That didn't seem right so I asked questions. I was told that through a 'make/buy' analysis it was cheaper to purchase those parts than to produce them ourselves. Cost Account managers showed me the analysis that involved the addition of \$3.75 in cost for every \$1 in labor to make the part. They referred to it as a "burden rate", and that it was a more accurate reflection of true cost. Once again I asked questions. "Did we lay off engineers, secretaries, etc. as a result of 'outsourcing'? True we no longer needed a second shift supervisor, and of course didn't have to pay as much for utilities at night, but did the impact on cash flow add up to anything close to the burden rate used? The answer was a definitive 'no'. Using burden rates in this decision process made no sense to me in the context of the first lesson ('if it doesn't jingle...')

I left GE in 1990 and began working with companies in a consulting and training role. In the early 1990s I learned my third and fourth lessons in what would later become known as 'Lean Accounting'. As we implemented 'continuous flow' and 'just-in-time' techniques in companies, the accounting folks became quickly displeased with our efforts. It would seem that the companies were becoming less 'profitable' as we steadily decreased inventory. Given my experience at GE and lesson #1, I dismissed it as a non-issue and pointed out the impact on cash flow which of course was positive. This was insufficient to accountants and non-accountants alike. Shortly before this I attended the business school at Cornell University where I learned among other things an equation that goes something like:

$$\text{Beginning Inventory} + \text{Purchases} - \text{Ending Inventory} = \text{Cost of Goods Sold}$$

and another one:

$$\text{Revenue} - \text{Cost of Goods Sold} = \text{Profit}$$

By these equations a continual reduction in inventory will always negatively impact 'profits' despite what common sense says about continuous flow and just-in-time. This was a true contradiction that further explained in part lesson #1. For the most part I was working with small to medium sized privately held companies the owners of which understood the importance of cash flow just like I did and we continued the efforts in spite of the arguments otherwise.

In the second half of the 1990s I began working with larger publicly traded companies and the inventory versus profit contradiction really became an issue, and one that many organizations today still struggle with. I would share my story about GE in the 1980s but with little effect. It was during this time I learned my fourth lesson about 'allocations'. You see small, privately held companies had income statements that were straightforward, and read like a

Consortium, the weeklong conference will include presentations from manufacturing, government, and education. Workshops on various topics will also be available. For more information [click here](#).

Lean HR Summit San Antonio TX

November 8-9, 2012

Leaning HR processes, HR's role in the Lean Enterprise, Culture and other topics will be covered in workshops, presentations and by keynote speakers. For more information [click here](#).

Lean Enterprise Institute Workshops

Seattle WA

October 9-11, 2012

Coaching Skills, Leader Standard Work, Optimizing Flow in Office & Services, VSM for the Office and more! [Click here](#) for more information.

**Be sure to check out
our publications!**

**"Lean Office & Services
Simplified"
(2012 Shingo Prize
recipient)**

**"The Complete Lean
Enterprise"
(2005 Shingo Prize
recipient)
VSM for Administrative & Office
Processes**

statement of cash flows. They provided meaningful information on cost. In large companies I found no such thing. Even worse, people couldn't even adequately explain the meaning behind the numbers that they were reporting. Nevertheless it was these same numbers people tried to use to determine if our 'lean efforts' (the term existed by this time) were effective. I longed for 'plain speak' financial accounting information that would show what some of us intuitively knew was true - that lean was the 'way to go'.

Fast forward over a decade later to today. Many companies are still wrestling with the various conflicts and contradictions that arise when lean and traditional accounting practices meet. This is evident by the various questions asked during a panel discussion at the conference. Most schools continue to teach traditional practices, and graduates are still ill-prepared to deal with the contradictions that arise. Most find it easier to go 'by the numbers' rather than engage in difficult discussions that would lead to better decision making and better results for the organization.

If you and your organization are encountering some of the issues that I describe, I recommend that you begin to educate yourself and others in your organization on this important subject of 'Lean Accounting'. And maybe I'll see you at next year's summit!

Best Regards

Drew Locher

Managing Director, Change Management Associates

"Unleashing the Power of 3P"

This soon to be released book tells the story of a turnaround of a company using the powerful 3P methodology to achieve breakthrough results. Companies are just now becoming aware of this approach and the concepts upon which it is based such as '7-ways', Bio-mimicry, and Rapid Modeling and Simulation. Click here for more information at [Productivity Press](#).



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"Help Wanted: Using Visual Management to Drive CI"

"Debunking a Myth about Lean Office"

"What's Your Problem? The Basics of Problem Solving"

"Can We Talk?" Encouraging Meaningful Conversations in Business.

"Because I Said So" Managing by Objective (MBO) versus Striving for Target Condition

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