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ARTICLES

A Review of Lean Accounting

By John Stancil, Associate Professor, Accounting, Florida Southern College

Through simplification and the removal of unnecessary work, accountants can achieve not just lean accounting, but leaner accounting. If done properly, the purpose of management accounting—to make better decisions—can be realized and even enhanced.

Gary Cokins of ABC Technologies states that the revolution brought about by Just-in-Time (JIT) techniques has now moved into the arena of cost accounting and performance measurement methods. Traditional systems are heavily involved in collecting and managing extensive cost accounting records. Unfortunately, the effort expended in this pursuit may exceed the benefits of the information provided.

Cokins states that the “lean management” community would prefer to see the accountants serve as change agents rather than as the “accounting police.” In pursuing traditional standard costing, accountants are trying to tell other sections of the organization where they need improvement without applying such techniques to their own operations. In this regard accountants should eliminate variance reporting, reduce the number of cost centers, eliminate detailed labor reporting, reduce the number of payable and receivable transactions, and cross-train within the accounting department. Transactions are likened to inventory in “lean” thinking—they are waste and should be eliminated.

Lean accounting seeks to break from the traditional absorption model, acknowledging that there are options to assigning costs. Ultimately, cost assignment comes down to the question, “What portion of variable costs do you include or exclude?” Taking this to an extreme is the idea of “materials-only costing,” in which materials are recognized as the only cost that is unique to the product. Any other costs are therefore costs of doing business—operational costs not related to any product. When followed in a textbook manner, material-only costing removes any recognition of heterogeneity in products. This results in over- or under-costing of products relative to actual resource consumption. In short, this “radical” approach ends up very similar to the traditional absorption model.

In stating basic principles of cost measurement, Cokins observes the following:

1) Allocating costs is bad. Allocation is, at best, arbitrary and does not provide any truly useful information for decision-making purposes.

2) Tracing costs is acceptable, but involves looking back in time, rather than being future-oriented.

What is needed is an understanding of how cost behavior varies in relation to other factors. Cokins contends that the rise in the percentage of costs that comprise overhead is due to diversity and complexity in products, services, and customers; quality level; and rates of needed change. To understand these behaviors requires the implementation of activity-based-costing (ABC) techniques. This approach will allow the accountant to obtain insight on what causes the magnitude of cost fluctuations for an activity. ABC does not replace the accounting system. It restates the same data and adds operating relationships which facilitates decision making.

Poor costing can have an adverse effect on the company’s bottom line. Misallocated costs can result in a profit condition where there are big losers and big winners. This cost subsidization has been shown to be very large, obscuring the true profitability of products. When constructing a profitability profile using ABC, it becomes apparent for many companies that by discontinuing the least profitable products, companies can significantly increase the profit picture. This profitability profile can be used to help determine the most profitable products, customers or services.

Applying these concepts to channel and customer costing reveals relationships that were previously not visible. In managing resources, decision making is enhanced through construction of an ABC/M Customer Profit & Loss Statement. The end result is better decisions are made because the data is more visible and the cost numbers have a higher degree of accuracy.

Cokins observes that lean accounting to support lean thinking is simply absorption costing, using principles of ABC/M. It must be understood that costing is a form of modeling and cost models are designed to give decision support to the purpose they are intended to serve. Leaner accounting, in Cokins' words "involves removing some of the unnecessary work that generates little utility for the organization." This is not the same as lean accounting.

Having dissected lean management, it is observed that lean is not the only popular management improvement program. Cokins forsees a blending of Six Sigma, Lean, and Theory of Constraints (TOC) with Target Costing and ABC/M. Each of these methods brings something to the table and can contribute to the creation of a more effective organization.

BIEC Chair Addresses Global Credential Results

As you know, the AICPA membership defeated a proposal to create a new global professional credential (The CPA Letter, Jan.). "While those of us who supported the new credential are disappointed, it was important to raise this type of issue with members and let them decide about future directions the profession should take," said Business and Industry Executive Committee Chair Gary M. Lubin, after learning of the results. "I hope that the AICPA will continue to explore innovative ways to reinforce the idea that, in addition to our financial expertise, CPAs are also leading providers of the strategic integration of knowledge."

Strategy Mapping

By Galen R. Sevcik

A summary of Cam Sholey's (Legend Consulting) "Strategy Mapping" Session

"Strategy mapping" is the process of determining objectives and means of getting there. The balanced scorecard (Kaplan and Norton) is one framework that can be used for strategy mapping. The balanced scorecard has four common perspectives: financial, customer, internal business, and innovation and learning. Each perspective commonly has from four to seven goals and corresponding measures. The scorecard is balanced in that it contains elements that are shortterm and long-term, financial and non-financial, and leading and lagging. A critical characteristic of a balance scorecard is that it should represent a translation of strategy.

Components of strategy mapping include (1) financial strategies, (2) strategic themes, (3) value propositions, and (4) critical internal processes. For financial strategies, an example of an overriding strategy may be to maximize shareholder wealth, which may be attained by other financial strategies, such as maximizing revenues, productivity and asset utilization. In setting strategic themes, the overall strategy must be decomposed from an internal viewpoint. The focus is on determining what must be done to achieve desired strategic outcomes. Three generic strategic themes are to increase customer value, achieve operational excellence, and exhibit good corporate citizenship. In setting value propositions, it is important to recognize that it is impossible to do it all. Instead, it is essential to focus on excelling in a few select areas. Three possible value propositions are product leadership, customer intimacy and operational excellence. Critical internal processes are those crucial operations that must be executed properly to achieve the value proposition chosen. They must be identified so that the organization can assess the current situation and develop any necessary skills. The process of determining critical internal processes assists in prioritizing spending in hiring and training.

Strategy mapping has many uses, for example: determining target market, communicating and understanding strategy, and detecting errors and improving strategic planning. When determining target market, the chosen value proposition dictates the focus of the organization while the related critical internal processes chosen dictate which customers will come calling. Using strategy mapping to refine the customer base is an iterative process.

Using strategy maps to communicate to managers assists senior management with ‘thinking out’ the strategic plan, allows senior management to articulate the plan to lower-level managers, and allows managers to link their relevant map segments to operational objectives. Strategy maps for communicating allows non-manager employees to see where they fit into strategy (including high-level goals), avoid strategy distortions, and link their relevant map segments to operational objectives.

Strategy mapping can help in error detection by making inconsistencies and gaps in cause-and-effect linkages more visible. Periodic review of the strategy map will assist in error detection before related problems become an issue. The graphical depiction of strategy make the entire strategy more understandable to all levels of employees and make it much more likely to get valuable input from a variety of sources.

Two common barriers to strategy execution are strategy and people. Strategy barriers include (1) problems and errors not being identified soon enough, (2) ineffective coordination of activities, and (3) goals that are too vague. People barriers include (1) insufficient employee capabilities, (2) insufficient training and development, (3) inadequate leadership and direction, and (4) poorly prepared line managers. Strategy mapping is part of the solution to these barriers to strategy execution.

In today's changeable economic climate, the organization has a heightened interest in financial security and needs auditors with the sharpest skills on the most current methodologies. The 2002 AICPA/IIA Value-Added Auditing Services Conference will be held April 24–26, 2002, at the Rio All Suites Hotel in Las Vegas.

This conference is ideal for CPAs, auditors and financial professionals who are looking to develop effective consulting strategies, master innovative auditing techniques and learn earnings management and auditors independence. You will also uncover some new ways to identify risks and money opportunities, while networking with peers from the IIA and AICPA.

The 2002 conference topics will also include:

- Enterprise Risk Management Trends and Emerging Practices
- E-Risk, Fraud & Ethics
- Complying with Security Issues
- Independence and Objectivity: A Framework for Internal Affairs
- The Future of Self-Assessment
- Earnings Management
- Joint Risk Assessment Audit Plan—Internal and External Auditors
- The Balanced Career Auditor
- Recruiting and Retention
- Disaster Recovery/Business Continuity Planning

For more information or a conference brochure, visit www.CPA2Biz.com.

AICPA Offers New National Performance Measurements Conference

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In a business environment that is demanding faster and cheaper solutions to complex performance problems, the ability to create effective and reliable measures is crucial. The AICPA is pleased to announce its National Performance Measurements Conference that is designed to demonstrate ways for you and your organization to appropriately and effectively measure the bottom-line impact of corporate initiatives. You will learn through real-world case studies how to develop credible and economical performance measurements strategies that will help you to demonstrate and quantify the value of your services.

The National Performance Measurements Conference will be held from July 25–26, 2002, at the Hotel Royal Plaza in Orlando, Fla. Conference highlights include:

- Multi-Perspective Development of Measures
- Virtual Close: The Value of Real-Rime Reporting
- Identifying Measures and Using Industry Benchmarks
- Measuring the Value of Knowledge Management
- Moving Beyond the Budget to Reach Higher Performance
- Measuring the Business Impact During Tough Economic Times
- Strategic Linkages and Pay for Performance

You can enhance your learning experience by attending the Pre-Conference Workshop. The topics included are Establishing Performance Measures that Drive Improvement and Strategy Mapping: The Use of Strategy Maps to Implement and Measure Organizational Objectives.

For more information or a conference brochure, visit www.CPA2Biz.com.

SEC Issues New Financial Reporting Release

On December 12, 2001, the SEC issued Financial Reporting Release No. 60, Cautionary Advise Regarding Disclosure About Critical Accounting Policies. In the Release, the SEC encourages public companies to employ an accounting and disclosure regimen that provides that if companies, management, audit committees or auditors are uncertain about the application of specific GAAP principles related to "critical accounting policies," they should consult with the SEC's accounting staff. The SEC staff has long encouraged companies and their auditors to consult with the SEC on not only accounting matters, but also on matters involving financial reporting and auditing questions, particularly those involving unusual, complex, or innovative transactions for which no clear authoritative guidance exists.

To assist registrants and their auditors with the most up-to- date information about when, why and how they may wish to discuss matters with the staff at the SEC, the

Professional Issues Task Force has issued Practice Alert 2002-1, Communications With the Securities and Exchange Commission. For information on how to obtain Practice Alert 2002-1, see the main section of The CPA Letter.

Electronic Newsletter Now Available for Members in Business and Industry

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BusIndNews is a bimonthly electronic newsletter that provides updates about what is going on at the AICPA and elsewhere in the profession with a focus on CPAs in business and industry. The newsletter spotlights issues that business professionals should be aware of and includes news of events such as conferences, seminars and Webcasts. Read BusIndNews to stay abreast of trends and developments in accounting and finance. What is best is that it is delivered straight to your desktop so you do not have to search for information that is relevant to you and your business.

If you would like to receive this free electronic newsletter, send an e-mail to elimandri@aicpa.org with the following subject message: Deliver BusIndNews.