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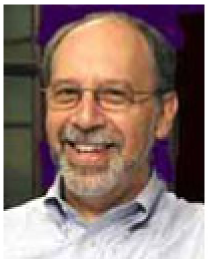
## Keeping score with lean accounting cost management



By Jerry Solomon

Lean accounting cost management, what people refer to as "lean accounting," is a different way of accounting for operations in manufacturing companies. For the people changing physical operations in the plant, lean cost management provides the tools that help them understand what's really going on.

Traditional accounting is a foreign language to the folks in the shop who have to use the information to improve. How can they improve something if they don't understand it? We have to make accounting information easy to understand, actionable, and timely.

If you go to a football game, you always know the score, how much time is left in the game, and what yard line you're on. Imagine if you went to a game and you didn't know any of those things. It would be pretty frustrating. In comparison, that's what traditional accounting provides the folks who have to use the information. They don't know the score; they don't know where they are; and they don't clearly understand the goals. Yet we give them numbers at the end of the month and tell them to make them better.

At MarquipWardUnited, we want people to understand how to keep score. We use a format we call the "box score." We determine the operational elements in the value stream that we want to track. Those are shown in the top half of the scorecard. In the bottom half we show financial performance. This includes the usual things: sales per employee, inventory turns, variable margin, and gross margin, for example.

Operational items are shown on top because we feel that's where people have to focus. If they improve the operational scorecard, the financial scorecard will get better. The flip side is, if we're making improvements on the operational side and the financial picture isn't getting better, we know we picked the wrong operational parameters.

Over time we have taken things off the operational scorecard because we saw an operation wasn't needed. An operation can be a big bottleneck, and after questioning why we put a product through that process, we decided we didn't need the step in the first place.

Tracking direct and indirect labor is something we move away from. We stopped recording labor hours for job costing. We have one payroll category: our work force. We want to measure our total labor content.

A traditional profit and loss (P&L) statement would show sales, cost of sales based on standard costing, labor variance, material variance, overhead variance, and labor rate variance. The people who need the information can't act on that.

We changed the format of our income statements. We made them simple. For each value stream, all of the payroll expense is in one bucket called processing costs. There is another bucket for all of our variable costs. We exclude elements outside the value stream, like property taxes or insurance.

Now the income statements allow the folks to clearly see and understand what was spent on labor, how many units were produced, and the labor cost per unit. It's pretty easy.

We clearly show the variable cost categories. Then we look at the variable costs each month and decide which cost categories we should focus on for improvement.

Fixed costs are generally out of the control of the folks in the value stream, so we don't ask them to give them much attention. However, we do make people aware of them.

We feel the scorecard helps people understand the business and see the fruits of their efforts manifested in better results. People want to know what they can do to make the business better, and link what they do to the financial results.

Many things happen when people work as a team, involved, questioning everything, and understanding the cost of everything. You have an engaged group, an entrepreneurial team improving operations.

Lean accounting is going to give people ownership. We want to make a whole bunch of mini-businesses and entrepreneurs in the shop who can improve the business. If we simplify accounting it's going to help.

I tell accounting people to get involved, understand what is going on in the shop, and make changes along with those made there. In so doing, you learn a lot more about the product, how it was manufactured, and its actual costs. It's an enlightening experience.

Excuses come in many different flavors and varieties. People say they can't do lean accounting as it's not GAAP (generally accepted accounting principles) reporting.

I can remember the time we were changing how we value inventory, and I was told, "You can't do that." I went to the accountant's bookshelf, pulled off the book, pointed to the page and asked, "Where does it say we have to account for inventory at the end item level?" The book said inventory has to be fairly valued. That's all. As long as we fairly value inventory in the lean environment it's not a problem.

Another obstacle is raised by folks who say, "Our auditors won't accept it." Yet there are a lot of world-class companies being audited by Big 4 accounting firms, including Toyota. Auditors will accept lean accounting. The key is to get your auditing firm involved early, explaining what you're doing, and educating them along the way.

People often don't want to change; we have to make them realize that change is how companies will be able to compete effectively in the global economy. So my advice for accountants is to stop looking at why we can't do it and start looking at why we must do it. Without the actionable information lean cost management provides the folks in the plant, we can't continually reduce costs. And it's a sure bet our competitors will not idly stand by as we contemplate whether or not to change.

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Interviews with Jerry Solomon are included in SME's video, Lean Accounting.

## Video Script:

MANUFACTURING INSIGHTS
Lean Accounting

MUSIC UP AND UNDER

NARRATOR (VO):
MANUFACTURING INSIGHTS, MANUFACTURING ENGINEERING MAGAZINE'S VIDEO SERIES FOR PROCESS IMPROVEMENT. THIS PROGRAM WILL EXPLAIN THE CONCEPT OF LEAN ACCOUNTING. AS A COMPANY MOVES TO LEAN THINKING AND BEGINS IMPLEMENTION, THE ONLY WAY TO TRULY MEASURE PROGRESS IS THROUGH LEAN ACCOUNTING. DURING THE NEXT FEW MINUTES WE WILL EXAMINE THE IMPORTANCE OF LEAN ACCOUNTING AND HOW IT SUPPORTS A LEAN ENTERPRISE.

WE WILL TALK WITH TWO EXPERTS IN LEAN ACCOUNTING. BRIAN MASKELL IS PRESIDENT OF B-M-A INCORPORATED. AND OREST FIUME WHO WAS VICE PRESIDENT OF FINANCE AND ADMINISTRATION AT THE WIREMOLD COMPANY. THEN WE WILL LOOK AT HOW MARQUIP-WARD-UNITED TESTED LEAN ACCOUNTING IN A SMALL "FOCUS FACTORY". THIS TEST HAS BEEN SO SUCCESSFUL FOR MARQUIP-WARD-UNITED, THAT THEY ARE POISED TO TAKE LEAN COMPANY WIDE. NEXT WE WILL VISIT SOUTHCO INCORPORATED, WHERE LEAN ACCOUNTING HAS HELPED THEM TO LEVERAGE EXISTING EQUIPMENT TO OFFER COMPETITIVE PRICING AND GAIN NEW BUSINESS. AND FINALLY, WE WILL GIVE SOME TIPS AND TACTICS TO CONSIDER AND USE WHEN CHANGING OVER FROM USING A STANDARD COSTING SYSTEM TO USING LEAN ACCOUTNING.

- TOUCH TO BLACK -

NARRATOR (VO):
THE CONCEPT OF BECOMING A LEAN ORGANIZATIONHAS GREAT APPEAL BECAUSE OF THE MINIMIZATION OF WASTE AND INCREASED CAPACITY IT CAN GENERATE. HOWEVER, LEAN CAN NOT BE APPLIED IN ONLY ONE AREA OF THE COMPANY. RATHER, IT IS A CULTURE CHANGE THAT WILL FLOW THROUGH THE ENTIRE BUSINESS.

SPECIFICALLY, LEAN ACCOUNTING IS A WAY OF REPORTING RESULTS ANYONE CAN UNDERSTAND. IT IS A SIMPLE WAY TO:

MEASURE PERFORMANCE,
REDUCE TRANSACTIONS,
GIVE A VALID ASSESSMENT OF THE FINANCIAL IMPACT OF IMPROVEMENTS,
DEVELOP VALUE STREAM COSTING TO MEASURE CONTRIBUTION MARGIN,
AND LEAN ACCOUNTING NATURALLY DRIVES THE BUSINESS TOWARD CUSTOMER VALUE.
IN THE BEGINNING STAGES, WHILE DEVELOPING A LEAN CULTURE, A COMPANY NEEDS TO INCLUDE THE FINANCE DEPARTMENT.

BRIAN MASKELL, ON CAMERA:
The reason it's important to institute Lean Accounting early in the Lean process is that traditional accounting systems are actively hostile to Lean. First, they motivate non-lean behavior through their behavior measurements. They're wasteful and expensive, because of all the transactions and complexity. They lead to poor decisions because the standard costs distort the financial information. And they show that bad things are happening when in fact good lean things are

happening. The traditional system is pushing back against what you're trying to achieve with Lean. There are other systems within the business that push back against Lean. The MRP system, the HR systems, union agreements, and other systems that have been built for supporting traditional manufacturing. They all push back against Lean, and the accounting system is one of those.

NARRATOR (VO):
AS FOUNDER AND PRESIDENT OF B-M-A INCORPORATED, BRIAN MASKELL, HAS MORE THAN TWENTY-FIVE YEARS OF EXPERIENCE IN THE MANUFACTURING AND DISTRIBUTION INDUSTRY. A SPEAKER AND AUTHOR, MASKELL SPECIALIZES IN HELPING COMPANIES BECOME A LEAN COMPETITOR.

MASKELL, ON CAMERA:
Changing the culture of a company to become a Lean-thinking culture, that's not done by saying "think differently." It's done by changing the way you act within a company. The accounting system is deeply embedded into the culture of the company. The accounting systems that have been developed for traditional manufacturing reflect the culture of traditional manufacturing. It's important to create accounting, control and measurement systems that reflect the culture of a Lean-thinking company. This would include things like working by value stream, focusing on the value to the customer, identifying waste, assisting in the removal of waste (stutter) ...and understanding the financial impact of decisions that you make. These things are all very cultural.

NARRATOR (VO):
ORRI FIUME, AUTHOR OF REAL NUMBERS - MANAGEMENT ACCOUNTING IN A LEAN ORGANIZATION, IS RECONGNIZED AS ONE OF THE LEADERS IN LEAN BUSINESS MANAGEMENT.

ORRI FIUME, ON CAMERA:
One of the problems that companies run into early on in the transformation process is when they make improvements operationally and it doesn't show up in the financial statements, or in fact shows up as a negative. I have yet to see a standard cost accounting system that could adequately give any information about improvements being made in operations. The subject of lean accounting is one that's still developing, but all of the people that are working in this area are working with several basic principles. One of the principles that everybody recognizes is important, is that financial information be presented in plain English so that people that don't have degrees in accounting can actually understand it. By the way, that's most of the people in the organization. If you present the financial information in plain English, what you're doing in operations becomes more transparent, and improvements can actually be seen. When we present financial information in a plain English P&L for example, our experience at Wire Mold was that when we distributed that P&L before the meeting, when we got to the meeting virtually anybody at the table could explain what happened that month by looking at the P&L. Whether it be the Vice President of Engineering, Vice President of Sales, it didn't matter, because they understood what the P&L was telling them. Our discussions around the P&L changed dramatically because I didn't have to sit there and explain it, it really became a discussion with people raising questions, because they had already read the P&L and they understood it. So it really became questions and discussion around what we needed to do. As a management group, that's a better use of our time.

NARRATOR (VO):
WHEN USING LEAN ACCOUNTING IT'S IMPORTANT TO HAVE A STANDARD METHOD OF COMMUNICATING THAT CAN SPEAK TO MANY DIFFERENT PEOPLE SUCH AS THE VALUE STREAM MANAGERS, THE FINANCIAL PEOPLE, SALES AND MARKETING AND TOP MANAGEMENT. AN EFFECTIVE TOOL TO CONVEY THIS INFORMATION IS THE BOX SCORE.

MASKELL, ON CAMERA:

The analogy for the box score is the baseball box score. But really what we're trying to do is present all the pertinent information in a way that's simple, clear and direct. The box score is designed to give a simple understanding of the status of the value stream. We're looking at three aspects of the value stream--how we're doing operationally, how we're doing financially, and are we making good use of the resources or the capacity we have available to us. So the top part of the box score shows the operational performance measurements that are being used for the value stream. The bottom part of the value stream shows a summary of the financial information--revenue, material cost, conversion cost, profitability, return, inventory levels. The center part of the box score shows the capacity and how well those resources are being used. How much capacity is being used productively, how much capacity is being used non-productively, and what's the available capacity. This is a summary and behind the summary is a lot more detail. But the purpose is to put on one sheet of paper a three-dimensional view of the value stream that gives a complete understanding of the value stream performance. We use the box score in many ways. One is for summarizing the financial performance for reporting purposes. That's typically done weekly. We look at the financial numbers and the capacity and the operational performance on a weekly basis. We would also use it for decision making. For example, if we have a request for a quote, maybe we have a buildup of demand over the next 12 months, and we would show how that affects the value stream operationally, how that affects is financially, and how the capacity usage would change with that new order coming in. Quite often you'll find something that appears to have low margins that can be very substantially beneficial to the company when you look at it step by step across the value stream over time.

NARRATOR (VO):
A FREQUENT CONCERN WITH LEAN ACCOUNTING IS "WILL IT BRING VALUE TO THE CUSTOMER?" LEAN ACCOUNTING IS PART OF A SUPPORT SYSTEM FOR THIS LEAN BUSINESS STRATEGY.

FIUME, ON CAMERA:
If I were to ask the customers of different companies what they expected, what they wanted, I would get some pretty long lists. If I compared all those lists, I would probably find three things on everybody's list. They want quality product, delivered on time, at a reasonable cost. Lean improves all those wants, if you will. Lean improves quality dramatically. Lean gives us the ability to shorten lead times and deliver product faster and more frequently, which helps the customer become lean and helps the customer so they can do business with a smaller investment in our inventory. And it helps cost equations in the sense that, through the productivity gains that we achieve in implementing Lean, as we are faced with market pricing pressures, we can respond to those pressures in a positive way because of the productivity gains we've achieved, without necessarily giving up profitability. So Lean accounting directly does not deliver value to the customer, but it certainly helps management make better decisions by seeing financial information that is more clearly understood, and helping deliver value to the customer in terms of quality, cost and delivery.

- TOUCH TO BLACK -

NARRATOR (VO):
SOME BUSINESSES BEGIN LOOKING AT LEAN ACCOUNTING AFTER WATCHING THE CHANGES LEAN MANUFACTURING CAN GENERATED. SOUTHCO, BASED IN CONCORDVILLE, PENNSYLVANIA, IS ONE OF THEM. OVER ONE HUNDRED YEARS OLD, SOUTHCO IS AN INTERNATIONAL COMPANY THAT DESIGNS, MANUFACTURES AND MARKETS ACCESS HARDWARE AND LATCHING SYSTEMS.

SOUTHCO GOAL IS TO LEVERAGE GLOBAL RESOURCES AND DELIVER CUSTOMER PROVEN SOLUTIONS, WHILE REDUCING THE OVERALL COST AND CYCLE TIME OF THE PROJECT. THEIR PORTFOLIO INCLUDES OVER 25-THOUSAND STANDARD CATALOG PRODUCTS AND OVER 50-THOUSAND CUSTOM PRODUCTS THAT HAVE BEEN CREATED TO MEET CUSTOMERS' DESIGN NEEDS. SOUTHCO BEGAN LOOKING AT LEAN

ACCOUNTING WHEN TRADITIONAL ACCOUNTING PRACTICES WERE NOT ACCURATELY REPORTING THE CHANGES THEY WERE MAKING IN LEAN MANUFACTURING.

STEVE MALRIAT, ON CAMERA:
We were into lean manufacturing for almost two years by the time we looked at lean accounting. Having had enough experience on some things that changed with lean, like inventory changes, that there were going to be financial impacts from the choices we were making. People get started with lean, and they think that means low inventories, not realizing that means you have to have processes capable if you're going to lower your inventory and still maintain customer service. Like most, we got started without all the answers, and we started reducing inventory. That adds additional cost to your P&L for the period, because you have the costs for the period and you have the cost of the inventory on the shelf going out on the P&L at the same time. It's devastating. It looks like the P&L is just vaporizing. In actual fact it was a beautiful cash play, because we were shipping this product out, not replacing it, so we weren't buying raw materials or getting inputs for cost or outlays of cash, but we were collecting cash from customers, so it was a tremendous benefit on the cash side. But the P&L would have suggested otherwise, that we were nosediving. But it was a temporary situation, and we at least had the foresight to say if that's what you're forecasting to happen, here's going to be the result from that. That's not obvious to people who just haven't lived the absorption accounting world, or the nonfinancial managers. They're very disturbed that things are really eroding fast and what's this lean thing, is it really working? In fact we're actually getting more nimble, as well as freeing up a lot of cash, which is the name of the game.

NARRATOR (VO):
UNDERSTANDABLY, MANY COMPANIES STARTING TO USE LEAN ACCOUNTING METHODS TO SET SHORT-TERM GOALS OF CUTTING COSTS AND INCREASING SALES. THEY ARE USUALLY DISAPPOINTED. THE FINANCIAL IMPACT OF A LEAN ENTERPRISE COMES FROM INCREASED CAPACITY AND THE CASH FLOW FROM REDUCED INVENTORY.

MALRIAT, ON CAMERA:
In and of itself, lean accounting didn't directly increase sales. What it did is it served to give us a clearer picture of, if we took on new business, a.k.a. add to our sales, what is the impact of getting that new level of sales. It allowed us to look at capacity, how it would affect our operating performance, and ultimately our financial performance. We have examples where, in a standard cost world, people would come to me all the time and say standard cost is higher than what I can get in the marketplace, I'm going to turn this down unless you can convince me that we're looking at the wrong answers here. So we took our standard hats off and looked at it very holistically and said well, do we have capacity in our manufacturing environments, machines and people, and if we don't, what do we have to add to bust through any constraints we're facing. Capacity constraints tend to really drive a lot of costs, because you're throwing a lot of resource to push things past the constraint. Then you add what is the outlay for material and external costs, and paint the real facts. This one example was a small piece of business that they were about to turn away, and it turned out to be a $100,000 contributor to the bottom line that year, virtually immediately. It was an existing product and we were able to leverage it. Our VP of Operations, who was looking at it from an operating point of view, whether we should take it or not, once we started going through the real facts, said what are we waiting for, get that order. It's really getting to the real answer and not some stake in the ground that may or may not reflect today's reality.

NARRATOR (VO):
ONE OF THE KEYS TO BEING ABLE TO ACT QUICKLY IS HAVING INFORMATION THAT IS ACCURATE AND UP TO THE MINUTE. BUILDING ON THIS UP TO DATE KNOWLEDGE, STEVE MALRIAT SAYS THEY WERE ABLE TO MONITOR TRENDS CLOSELY. THE TOOL USED TO GATHER AND DISTRIBUTE THE LATEST RESULTS WAS THE BOX SCORE. PROVIDING SOUTHCO EMPLOYEES WITH THE MOST CURRENT RESULTS, THE BOX

SCORE ALLOWS THEM TO PEEL AWAY ALL THE WASTE AND SEIZE THE OPPORTUNITIES FOR GROWTH.

MALRIAT, ON CAMERA:
The box score card is really a three-pronged quick scorecard of metrics that measure how the factories are operating, various operating metrics from delivery performance, our investment in inventory, how our quality levels are, what our capacity is, all the way through the value stream. What are we able to get out of that value stream, what are the current demands, what's available that we can leverage. The third aspect of it is financial, that brings us to quantifying how we utilize our capacity. When we look at new business opportunities, the box score is right there to guide us to say if we take this on, we have plenty of machine capacity and people capacity, or we don't, in which case we have to add this machine or this person or whatever it would take to take on that business. Then we look at it holistically.

NARRATOR (VO):
USING THIS HOLISTIC VIEW IT IS EASIER TO DECIDE IF THERE WILL BE A FINANCIAL REWARD FOR EACH BUSINESS OPPORTUNITY.

MALRIAT, ON CAMERA:
We also use it for just week to week. We measure box scores weekly. When we do kaizan events or any kind of activity where we're expecting a better result, we look at the next week and see if we can see it. If we rely on just the financial statement process, that's every month and it doesn't close immediately, so it's a couple weeks into the month before we give you the answers. So it can be six weeks sometimes after what really happened until we learn did we get what we thought we would get. This way we get it every week. We take a temperature check and see if we made improvement. If we didn't get what we expected, then we look for the next week and what can we change so we can get what we expect at the following box score meeting. We sit back down and collaborate over what can we do to improve the results. Little by little, over a long period of time. And you can watch. Our box scores or metrics are trended. So it's not about any one week necessarily, but over time are we making steady progress. Lean is not about one year out we expect to be a lean world class company. It takes deliberate effort over a long period of time to just peel away all the waste opportunities we can attack.

- TOUCH TO BLACK -

NARRATOR (VO)
AT MARQUIP-WARD-UNITED, LOCATED IN HUNT VALLEY, MARYLAND, LEAN ACCOUNTING BECAME THE TOOL THAT ALLOWED EVERYONE FROM THE FRONT OFFICE TO THE SHOP FLOOR TO TALK THE SAME LANGUAGE ABOUT MEASURING MANUFACTURING OPERATIONS.

JERRY SOLOMON, ON CAMERA:
In terms of why it's important to the company, we just think it's an easier way of doing business. It's also critically important as we change our manufacturing operations and change the way we physically do things out on the shop floor, we have to change the way we keep track of it. That's what we call lean cost management. When you think about lean cost management, it's really tools to provide users, or the people that are changing the physical operation in the plant, the tools to allow them to understand what's really going on. Right now accounting is a totally different language. It's a foreign language to the folks in the shop that have to use the information to improve, and how can they improve anything if they don't understand it. So we have to make it easy, we need to make it actionable, and we need to make it timely. That's what lean cost management is all about. Lean accounting has changed the way decisions are made. For example, when we design things or evaluate costs, what we typically do is try to get the lowest bill of material cost for every end item. So what you're looking it is, in isolation, one small piece of the cost of a product, then you add those all up and get the total cost. When we do a value stream map or value stream costing of the operation, we're really looking at the total system cost. To an

accountant, to me that is the greatest thing, because now we can make decisions on how we optimize the system, instead of how we optimize one small piece of it, when we may just be transferring cost to another element of the operation. As an example, as you might see later, at our other plant we used to purchase material from Budapest, Hungary, one of our divisions. The thought was that if we buy those end items over there and import them to the U.S., it would be cheaper. After we did value stream mapping and value stream costing and took into account total system costs, we actually moved some of the operation to the U.S. So it does change decisions, and it can change them quite dramatically.

NARRATOR (VO):
ON AVERAGE, A TRADITIONAL ACCOUNTING DEPARTMENT WILL SPEND SEVENTY-PERCENT OF ITS TIME ON ROUTINE BOOKKEEPING AND REPORTING. TWENTY-PERCENT IS DEVOTED TO MANDATORY HOUSEKEEPING ITEMS AND ONLY TEN-PERCENT ON ANALYSIS THAT WILL HELP THE COMPANY PREPARE FOR THE FUTURE. MARQUIP-WARD-UNITED IS CONSTANTLY WORKING TO ELIMINATE UNNECESSARY DATA ENTRY AND TRANSACTIONS. THIS HAS HELPED TO REDUCE THE TIME BETWEEN TAKING AN ORDER AND PRODUCT DELIVERY.

KAROL WARNOCK, ON CAMERA:
Because we were entering discrete part numbers, we would have engineers enter a new number for every time we sold a roll, which would be two transactions per order. We made 600 transactions a year just for that, times 3, because every end and body had to have a unique part number, all those drawings had to be made as particular detailed drawings. Now we go with one drawing, which takes considerably less time. It's like a Word document, as opposed to an engineering drawing with a picture of a Roll in the more traditional style. So it probably has reduced our transactions by a good 10,000-15,000 a year, in a lot of the Engineering and MRP functions. They no longer enter any kind of routing into the system, nothing detailed. It's all done off an Excel spreadsheet, and you simply select the operations that need to be performed. What we learned was that every Roll was not unique, so much as it was a subset of operations of what it could be. So we have the worse case scenario in an Excel spreadsheet, and when you sell an order you simply delete the operations that won't fly and hit the print button. That now is done in about 5 minutes instead of about 32 hours. And the great thing with that was we had about 80 orders in backlog. One of the first stumbling blocks we found when we first value streamed was our inability to even get the order to the manufacturing floor in a reasonable time. It would take us months to get it out onto the production floor by the time Engineering did what they wanted to do, and the custom routings were built. Now we can take an order and flow it. It averages two days. It can be done in as little as 15 minutes if we need do.

NARRATOR (VO):
MARQUIP-WARD-UNITED HAS A LONG RANGE GOAL OF ELIMINATING AS MANY DATA ENTRIES AND TRANSACTIONS AS POSSIBLE. THE BURDEN OF PAPERWORK, THE COMPANY HAS FOUND ACTUALLY SLOWS DOWN THE PROGRESS MADE BY LEAN THINKING.

SOLOMON, ON CAMERA:
It's very difficult to go down the traditional accounting path and implement lean manufacturing. For instance, labor reporting. We traditionally have direct labor and indirect labor. That always amazed me, because I ask people, does the money come out of different accounts for the direct vs. the indirect labor? They're both a cost of doing business. So the whole notion of direct and indirect labor is something we move away from. When we move away from it, we have one category, that's our work force. What's our total labor content. We eliminated all job costing, all labor transactions. How many hours did you get this week, that's what we're paying you for. The other reason it becomes very difficult to track labor in a lean environment is because we're going to cross-train everyone. They're going to be moving from job to job all day. If you were going to track that in a traditional way, you'd be overwhelmed with transactions and people spending time clocking in and clocking out instead of doing value-added work. So yes, we've removed a lot of

transactions, particularly labor. In our routings we've eliminated routings on the computer, we just have paperwork that follows the work. We check off some boxes. We don't have any standard costs, we don't have any variances. We have a target cost, and our goal is simply to get better each and every day. So we find out what our average cost was this day, this week, this month, and our goal is to get better. So we've eliminated 95 to 98 percent of labor transactions, all of our labor routings, a lot of shop floor paper. We eliminated purchase orders, and it could go on and on. I would say all in all probably 90 percent of transactions have been eliminated. The goal is not just to eliminate transactions. Really what we want to do is the people that were spending time doing those transactions are now helping other folks improve the business, engage in the business, be part of the improvement teams. Some people might think if you eliminate all that work, now we don't need the folks. No, we want to redirect the folks to things that add value. So it has been fun, and it takes some of the drudgery away from the folks in terms of doing clerical work.

NARRATOR (VO):
BY REDUCING TRANSACTIONS AND SIMPLIFYING FINANCIAL REPORTS, LEAN ACCOUNTING HAS CHANGED THE WAY DECISIONS ARE MADE AT MARQUIPWARD UNITED.

DENNIS HENTSCHEL, ON CAMERA:
The lean accounting has helped me in forecasting and budgeting tremendously. The main reason is the people understand the numbers. The people running the operation understand what they're spending, what they're going to spend, they provide me with information that makes it more easy to forecast. They actually do the forecast and get it to me. With traditional accounting, because you're probably the only who really can get through all the numbers, you come up with the forecast. You give it to the operations people and you ask them does this look right? This works the other way around. They give you the forecast and you review it with them.

NARRATOR (VO):
WHEN CONSIDERING MOVING TO LEAN FROM TRADITIONAL ACCOUNTING PRACTICES A KEY ELEMENT IS PACING. ACCORDING TO THE EXPERTS, SWITCHING TO A LEAN BUSINESS MANAGEMENT SYSTEM SHOULD BE IMPLEMENTED OVER TIME AS THE NEW METHODS ARE LEARNED AND APPRECIATED.

FIUME, ON CAMERA:
Many people ask, where do I begin? How do I start this transformation process to Lean accounting? What I recommend to people is that they have to understand the changes that are being made in the operational areas in order to understand the changes they need to make in the accounting area, and the pace of that change. If we change our business processes significantly faster than the rate at which the operation is changing, we run the risk of creating havoc. If we change the business processes at a rate significantly slower than the rate of change that's taking place in the operation, we run the risk of becoming blockers. So as financial people we have to become much more familiar with what's happening in operations than we ever were, and the only way to do that is really to spend more time physically in the operational areas. With regards to the financial statements, because we have a period where part of the operation is implementing cells and flow, and part of the operation is still in a batch and queue mode, it's a very difficult period from an accounting standpoint. What I recommend to people is that they produce the standard cost statements as they always did. Then as supplemental information, produce the plain English P&L also, and run those two in parallel for some period of time. At Wire Mold we ran in parallel for probably 14 or 15 months before we shut off the standard cost statements. But it's during this period when you run parallel that you have the opportunity to really understand the bridge between the old and new method of looking at your financial information.

NARRATOR (VO):

TO MAKE A SUCCESSFUL TRANSITION TO LEAN ACCOUNTING, THE ENTIRE ENTERPRISE MUST CHANGE THE WAY THEY DO BUSINESS BOTH INTERNALLY AND EXTERNALLY WITH SUPPLIERS.

MASKELL, ON CAMERA:
Some of the roadblocks to implementing Lean accounting are traditional things like people's resistance to change. To overcome that roadblock you have to demonstrate the importance of making the change. This is similar to Lean manufacturing. Many people really resist that until they really get it, and it's the same with Lean accounting. You have to kind of get it and understand why it's different. Another roadblock is that Lean accounting works by value stream, and that means that various departments of the company that have in the past worked independently, now need to work together. Decision making has to be more of a consensus rather than the product manager having the last say, so there is sometimes some objection there. There's also the pseudo-objection of saying this can't apply to generally accepted accounting practice, and will the IRS and SEC accept this. In fact Lean accounting is better suited for that kind of external reporting than traditional accounting.

NARRATOR (VO):
BY PROVIDING REAL NUMBERS IN A TIMELY AND UNDERSTANDABLE WAY, THE ROLE OF THE MANAGEMENT ACCOUNTANT BECOMES INTEGRAL IN VALUE-CREATING BUSINESS FUNCTIONS. AS KEY PLAYERS ON THE VALUE STREAM TEAM, FINANCE PEOPLE SUPPLY INFORMATION ON ACCOUNTING, CONTROL, AND PERFORMANCE MEASUREMENTS THAT SUPPORTS AND ENHANCES THE CONTINUOUS IMPROVEMENT PROCESS. THE LEAN MANAGEMENT ACCOUNTANT CAN BECOME A CHANGE-AGENT WITHIN A WORLD-CLASS ORGANIZATION.

- FADE TO BLACK -

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