

## **D. T. HICKS & CO.**

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Dear Executive:

This past December, an article titled “Does Accounting Information Mislead Manufacturing Engineers?” that I prepared for the Society of Manufacturing Engineers was published in their monthly periodical *Manufacturing Engineering* under the heading “Do You Know Your Costs?” About a week after the article appeared in print, I received the following communication from Edmund Herman, President of Creative Concepts Company and a retired General Motors Corporation manufacturing engineer:

*“Dear Mr. Hicks,*

*I read with great interest your article, “Do You Know Your Costs?” in the December issue of Manufacturing Engineering. The obvious answer, as you obviously know, is categorically NO! I am a retired manufacturing engineer from General Motors and I am the kind of guy that you would like to help. My entire career was spent trying to design and set-up manufacturing systems that were least-cost systems. There is always more than one technically correct way of doing anything. The name of the game is to select the least cost one. My operations research training helped me realize that the cost data at my disposal, or the cost data that someone else applied to my systems, were totally bogus most of the time for all the reasons you point out in the article and some that you didn’t include. I am appalled as I look around and see a general back sliding (even greater watering down) in costing systems rather than advancement.*

*I have reached several conclusions.*

- 1) As you point out, product costing is the responsibility of the engineering community rather than the accounting/financial community.*
- 2) There is near total confusion regarding the separation of product manufacturing cost and product price.*
- 3) Operating information systems are not cost based so there is not data available.*
- 4) Every activity must have a well defined and overt cost basis defining the cost structure of the activity and its charging rate. (This is the foundation of an effective system) Not having such data discourages people from pursuing activity based costing because of the gut wrenching and time consuming effort needed to develop every little cost tidbit. It has to be built-in.*

- 5) *The concept of “direct” and “indirect” costs must be banished from our vocabulary. Everything that happens to a product as it is being created costs something and that cost must be directly applied. It can be useful to know which activities are value adding and which are not, but those distinctions do not enter into the cost calculation.*
- 6) *The manufacturing cost to produce a product must not include any cost, no matter how small, that is not used to manufacture that product.*
- 7) *A manufacturing facility will have lots of resources that are not totally utilized producing parts. It is never possible to fit all the pieces of the puzzle together perfectly. So, the sum total of all the product manufacturing costs will never equal the cost of running the business.*
- 8) *Finding work for and/or divesting of un-used resources should be a major effort on everyone’s part. All the little bits and pieces must be identified and quantified.*
- 9) *Pricing can (hopefully) span the difference between product manufacturing costs and the cost of running the business.*
- 10) *Market value and/or budgets must never influence the estimated cost (delusion) or calculated actual cost (cheating) of making a product.*
- 11) *It does not “average out”. Small errors appear to not matter much to the bottom line, but they always nudge the business in the wrong direction; slowly at first but with acceleration.*
- 12) *It is not “too small to matter”. A good activity based costing system will show that a very large percentage of the products do cost about what the traditional system shows. But, the 5% that actually cost more than what one thinks they do will attract more of that kind of money losing work while those that are shown to cost more than what they do will be lost to competitors with no tears shed. Again: nudging the business in the wrong direction.*
- 13) *It is not “too costly”. The problem of system cost is not with activity based costing, it is with having operating information systems that are patch work quilts with overlaps and gaps and no cost basis. With a rational re-design and implementation of good systems and with computerization, the whole thing can be inexpensive, simple to use and intrinsic to getting parts out the door.*
- 14) *Managers are quite willing to go out of business rather than face up to having good systems. Besides, if they knew their true costs they would have to kill some sacred cows.*

*I hope I did not bore you with all this, but your article tweaked a frayed nerve ending”.*

Of course, Ed’s letter did not bore me. It merely reinforced my belief that the cost information generated by today’s accounting departments does more to harm their organizations than help them. I especially liked Ed’s 14<sup>th</sup> point. I do believe a lot of – if not most – accountants would rather see their company go out of business than have to adopt new costing methods and models. It remains a twenty-five long year mystery to me why accountants are so apathetic about the quality of the cost information they provide management.

Ed was not alone in reacting to the article. Typical of the other responses was this comment by an experienced engineer with a major medical device manufacturer:

*“I was glad to read that I was not the only person that was doubtful of the legitimacy of the practices used in cost accounting. In my 24 years as an engineer, I have always avoided the financial side of design and manufacturing, mainly because I was frequently confused by the process used by the purchasing and accounting departments in arriving at the cost of a finished product, especially when it seemed to be contrary to what I knew to be the facts.”*

If accountants aren't going to take the lead in developing quality cost information that supports sound decision making don't you think it might be time they gave the responsibility to someone within the organization who will? In case you missed the article, it's available on line at: <http://www.sme.org/cgi-bin/find-articles.pl?&ME09ART55&ME&20091201&&SME&#article>

### **Leadership Accounting: Driving Economic Value for Your Organization**

The past few summers, as the Board of the Metro Detroit Chapter of the Institute of Management Accountants has been planning the upcoming year's program, they've looked my way and said, “Doug, you'll take care of the March program, right?” and each time I've said, “Sure, no problem.” The first few years I prepared and delivered the sessions on my own. By the time 2008-2009 year rolled around, however, I figured everyone was getting tired just listening to me so I recruited my old friend Ravi Nayar to join in the fun. The result was the most successful March session in years. Needless to say, when the Board was planning the 2009-2010 year's program they asked me the same question and I gave the same answer.

A few weeks later, I was working on my computer in the garage (puffing on a Punch Double Corona) on a Saturday afternoon and began thinking about the March 2010 program. I rather enjoyed not doing 6 hours of CPE on my own and thought how great it would be if I could get a few additional presenters to add even more variety (and quality) to the day (and make it less work for yours truly). I identified a few of the local speakers I could get involved, but then thought to myself, “Why not at least try to get one ‘A List’ presenter on the program? It's at least worth a try. After all, I've got over eight months to get this thing organized.”

I immediately e-mailed three “A Listers” to see if they'd be interested in visiting Detroit in March to present. The three were: **Jeff Thomson**, President and CEO of the Institute of Management Accountants, **Jim Huntzinger**, President and Founder of The Lean Accounting Summit, and **Gary Cokins**, Global Product Marketing Manager for Performance Management at SAS Institute. Within a few days all three said they'd be happy to participate. I shouldn't have been surprised because all three of these guys are passionate about their subject and are generous with their time.

As a result, I'm proud to announce that on Thursday, March 18<sup>th</sup>, the Metro Detroit Chapter of the Institute of Management Accountants will be sponsoring a 6-CPE hour event titled *Leadership Accounting: Driving Economic Value for Your Organization*. The speakers include the aforementioned **Jeff Thomson**, **Jim Huntzinger**, **Gary Cokins**, plus **Ravi Nayar**, Vice President Business Strategy and IT Consulting at Accretive Solutions, and – last and probably least – me.

This event will take place at the Crowne Plaza Hotel adjacent to Detroit Metropolitan Airport in Romulus, Michigan and run from 9:00am until 4:00pm. The fees for the program are \$110 for IMA members and \$125 for non-members.

The theme of the event was prompted by the following paragraph from Gary Cokins' recent book *Performance Management: Integrating Strategy, Execution, Methodologies, Risk, and Analytics*:

**“Management and leadership** are not the same thing. Management copes with **complexity**, relying on budgets, plans, targets, and organizational charts. Managers tend to follow rules and are risk adverse. In contrast, leaders cope with **change** – change that is accelerating. Leadership requires vision, direction-setting, inspiring employees, and intelligent risk management.”

The session is comprised of the following five presentations followed by an open forum where speakers and attendees can discuss the concept of “leadership accounting” and the challenges faced by management accountants as they strive to drive economic value for their organizations:

Creating Value through Values: A Leadership Priority

Jeff Thomson – President and CEO, Institute of Management Accountants

The cornerstone of IMA's business strategy is to drive sustainable value to members through certification and education in the areas of risk management, internal controls decision support, and more. But the leadership challenge – a priority, in fact – is to ensure that a culture of respect, integrity and innovation serve as guideposts and table stakes to achieving the end game: enhanced careers, transformations in organizational performance, and, stronger economies driven by sustainable value.

Accounting for the Right Reasons: Leadership by Learning

Jim Huntzinger – Founder and President of the Lean Accounting Summit

Accounting for Lean is the design, execution and continual improvement of the operation (production, service, or information), and is at the core of managerial accounting in the framework of a lean business model. A walk through the actual events of the transformation of a manufacturing operation will illustrate just how the physical changes develop the thinking behind lean accounting. And learning through experimentation, trial and error, and failure is the means to evolve and develop the design and support of managerial accounting for the lean model: that is, the development of people.

Accounting Leadership in Overcoming the Obstacles to Successful Performance Management

Gary Cokins – Global Product Marketing Manager for Performance Management, SAS Institute

Implementing Performance Management (PM) methodologies that enhance business success can prove to be an arduous and challenging task. Proven concepts such as strategy maps, balanced scorecards with KPIs, customer profitability reporting, driver-based budgeting, and activity-based cost management often fall victim to speed-bumps, pitfalls, and other barriers that lurk within an organization. Effective leaders, especially leaders in management accounting, are able to identify and overcome these barriers and, in the process, lead their organizations into a more successful future.

### Leadership through Management Information

Ravi R. Nayar – Vice President, Business Strategy and IT Consulting, Accretive Solutions

Data abounds today in the business world. The challenge is to harness the ever exploding well of data into meaningful management information and organizational knowledge so that leadership in an organization can be facilitated and nourished. Management information is a key component to establishing a vision for your organization, setting strategic directions and moving the organization through the necessary transformative stages, all key aspects of exercising leadership in an organization. Information technology continues to advance in its capabilities to provide the relevant knowledge in a “pull” fashion. The session will focus on the technological aspects of generating management information, the challenges faced by organizations in generating and harnessing knowledge, and how to overcome these challenges.

### Leadership: The Accountant as Decision Support Executive

Douglas T. Hicks – President, D. T. Hicks & Co.

The primary difference between financial accountants and management accountants isn't the type of organization that employs them – it's the focus of their work. Financial accountants are historians who care only about reporting historical results following one-size-fits-none, man-made rules. Management accountants are futurists who don't just predict the future, they help create that future and drive value in their organization by enhancing their company's decision making processes; they serve as their company's decision support executives. To be effective, a management accountant's vision of the organization must be much more comprehensive and reality-based than the financial accountants' superficial, rule-compliant view of the company.

All speakers plan on being at the event for the entire day, so attendees will have plenty of opportunity to meet them personally and exchange ideas.

You can sign up for *Leadership Accounting: Driving Economic Value for Your Organization* at: <https://s07.123signup.com/servlet/SignUp?PG=1532266182400&P=1532266133465117159082800>

I hope you all had a great holiday season. I look forward to hearing from any of you who have questions or comments regarding this quarter's letter. As always, please feel free to forward a copy of this letter to anyone you believe would be interested.

Very truly yours,

*Doug*

Douglas T. Hicks, CPA, CMC  
President