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*“Count what is countable, measure what is measurable, and what is not measurable,
make measureable.”*

- Galileo Galilei

December 2011

Dear Executive:

We're about to begin 2012, nearly three decades since the dangers of using traditional – especially direct labor-based – costing methods to develop decision support and performance measurement information were clearly documented by the likes of Kaplan, Cooper and Johnson. Since then a vast body of knowledge and experience has been accumulated, documented and liberally disseminated, including solutions to the “costing problem” for organizations of any size and in any industry. Yet as we enter 2012, a vast majority of organizations continue to supply their decision makers with an irrational jumble of nonsense – disguised as cost information – as support for making decisions critical to the survival and growth of their organizations. Is it any wonder that organizations whose cost information provides its decision makers with a distorted picture of economic reality consistently underachieve (that's if they're lucky...the unlucky ones ultimately fail)?

Business success is dependent on the quality of business decisions and the quality of those business decisions is dependent on the quality of the models and information that support them. Dysfunctional cost models generating an irrational jumble of nonsense – like most of today's costing models - are not conducive to financial success.

Don't you think that 2012 would be a good year to stop basing your company's critical business decisions on economic fantasy and being basing them on economic facts?

Quoting and Cost Estimating in the Auto Industry

Back in 2009, my friend Chis Domanski began the “Automotive Cost/Price Estimators, Engineers & Analysts” group on LinkedIn. Over 700 individuals have joined the group. The two years of discussions that I've read (and participated in) have only gone to prove the assertion I made many years ago that estimators in the auto industry are not cost estimators at all; instead, they are price justifiers.

Although a vast majority of the group's members have shown themselves to be quite skilled at estimating the cost of materials and components, few appear to know even the most rudimentary concepts of accounting for the ever growing pool of activity costs that exists at today's auto suppliers. I've discussed the specifics of this problem in many of my earlier letters

so I won't go into them here. Even more disturbing is the fact that few appear to even care. I recently received an e-mail from one of the members who said "I'm dumbfounded by the fact that whenever you, John Daly, or any other expert in the field of costing contributes a rational comment to one of the discussions, it seems to be ignored. The discussion proceeds as if your comments had never been made."

The two primary concerns of the group appear to be learning how to complete an estimate in less time and finding out what add-on cost and profit percentages they can "get away with." Learning how to develop an accurate estimate of the likely cost of actually producing a product seems to be of no concern at all.

The following is one of the largely ignored comments I've made during the course of the group's discussions:

Costing vs. Pricing

Cost has nothing to do with price; the market determines price. Cost determines whether a potential supplier wants to provide the product or service at the market price.

Companies that must "bid" for work generally estimate the cost of doing the work, add a target profit, and then submit the bid. Sometimes they get the work and at other times they don't. After going through the process several thousand times, the individuals involved in quoting start to merge the two concepts – costing and pricing – together as if they were the same thing. They are not. When a potential supplier submits a bid, they are "fishing" for a market price they would find acceptable, not determining the market price. Many times the market price is actually higher than their bid and they leave a lot of money on the table simply because they believed that their cost had something to do with market price.

In the short term, the market does not impact a company's cost (in the long term the market can motivate a company to improve its business processes and bring down its costs) so any company that modifies its costs by "sharpening its pencil and trying again," overstating its throughput rates, modifying its overhead rates, or other artificial means so it can lower its bid price is only lying to itself. It will happily accept work on which it pretends it is earning a nice profit when, in reality, it could be taking on "a dog" that will haunt it for months or years to come.

Your costs are based on how your business operates. Prices are based on how the market operates. If you want to earn your 10% or 15% profit, you need to determine what your costs are most likely to be - not what you'd like them to be – and see if that price catches the fish. If it doesn't, you can decide to accept a lower profit margin. You cannot, however, "play with your cost estimate" to reduce your cost and try again at the full profit margin. That's just lying to yourself.

Until the auto industry gets serious about estimating the likely cost and true profitability of the products on which it submits quotations it will continue to win those unprofitable contracts on which it does not charge the customer for work it does for them and lose out on profitable contracts on which it tries to charge the customer for work it doesn't do for them. This doesn't appear to be a very wise practice for an industry so vital to the economic well being of our nation.

Cost Methodologies With a Name

After observing and actively participating in the development of cost and performance measurement and management during the past quarter century, I've come to the conclusion that any costing methodology that gets a name (e.g., ABC, RCA, Value-Stream Accounting, Throughput Costing, GPK) is fatally flawed. The problem comes from the fact that once a

methodology is given a catchy moniker, it becomes a dogmatic set of mechanics that wins followers who contract tunnel vision and treat it as “the one true faith.” You’re either for it or you’re against it. More than once I’ve encountered individuals that told me, “We tried {enter any methodology} and it didn’t work for us so we switched to {enter another methodology}.”

Software developers and consultants whose practices are dependent on implementation of that software only pour more fuel onto the fire. Their businesses only flourish when they convince customers that they are the ordained apostles of that one true faith. It’s possible that they actually believe what they profess, but the way many of them switch from one methodology to another as the popularity of one wanes and the other advances makes it seem unlikely. There’s nothing particularly evil about this, they’re just a bunch of “working blokes” trying to make a living. It does not, however, help us solve the problem.

Thomas Edison is quoted as saying “it is remarkable to what lengths people will go to avoid the process of thought.” I heartily agree with his observation. People want to be handed ready made answers to their problems. They don’t want to work them out for themselves. That makes them susceptible to ideas and methodologies that contain a “nugget” of truth but that fail to actually solve their problems. Named costing methodologies fall into this category. Each of them contains a nugget of truth – that’s how they are able to gain acceptance. From some perspective, each one appears to be the solution to the believer’s problem. Once accepted as the one true faith, all of the methodology’s faults are either overlooked or viewed as inconsequential.

The only real solution to the costing problem is the creation of a model of the organization that 1) incorporates all of the *significant* economics underlying its operation and 2) provides decision makers with the wide variety of cost information they need to make economically sound business decisions. Back in 1923, John Maurice Clark stated in his classic book *Studies in the Economics of Overhead Costs*, “We may start with the general proposition that the terminology of costs is in a state of much confusion and that it is impossible to solve this confusion by discovering and adopting the one correct usage, because there is no one correct usage, usage being governed by the varying needs of varying business situations and problems.” He continued, “As a result, if cost accounting set out, determined to discover what the cost of everything is and convinced in advance that there is one figure which can be found and which will furnish exactly the information which is desired for every possible purpose, it will necessarily fail, because there is no such figure.” Unfortunately, developing accurate and relevant cost information requires “the process of thought” – not adherence to some “one-size-fits-all” dogma – so it’s unlikely that any pre-packaged methodology with a name will be the solution.

Cost Accounting Position Requirements

Did you ever notice that the requirements listed for a position in cost accounting seldom included anything like “must have an up-to-date knowledge of cost accounting concepts and practices?” On the other hand, they almost always include a statement to the effect that “candidate must be experienced in the use of {enter the name of the hiring company’s ERP system}.” In short, individuals being recruited for cost accounting positions are not expected to think or contribute to the quality of their employers’ cost information. They are, instead, expected to keep their ideas to themselves and insure the precision of the inaccurate and irrelevant cost information generated by the dysfunctional cost model on which their ERP software is based. “*Not ignorance, but ignorance of ignorance, is the death of knowledge.*” – Alfred North Whitehead.

IMA Metro Detroit/Toledo's 2012 Management Accounting Conference

The Metro Detroit Chapter of IMA has partnered with the IMA's Toledo Chapter and Greenstone Professional Services to present its 6th Annual Management Accounting Conference at the Metropolitan Hotel (next to Detroit Metro Airport) on March 22, 2012. The theme for this 8 CPE-hour event is "Management Accounting's Role in Revitalizing US Manufacturing."

This year's featured speaker will be Larry White, former Chair of the Institute of Management Accountants and currently Executive Director of the Resource Consumption Accounting Institute. Larry is also Chairman of the IMA's Managerial Costing Conceptual Framework Task Force – a group that includes previous conference speakers Gary Cokins and Jim Huntzinger. He will be conducting our two major sessions, one covering the IMA's new Managerial Costing Conceptual Framework and another explaining the concept of Resource Consumption Accounting.

In addition to Larry, Steve Martin of BKD, LLP will be sharing lessons that can be learned from the profit-eroding errors made by the manufacturers he has worked with during his time as a turnaround consultant; Robert Abraham of Greenstone Professional Services will be discussing practical applications of cost accounting in ERP systems; Jon Anderson, long-time CFO at several mid-sized auto suppliers, and I will be describing how one mid-sized manufacturer substantially improved its profitability by adopting activity-based concepts (without "implementing" Activity-Based Costing); and I will be discussing how a manufacturer can overcome the costing distortions inherent in using GAAP-based depreciation expense and how to effectively measure the ROI of individual products, product lines, customers and markets.

Additional information regarding the conference – including its schedule, fees and registration process – is attached to this letter. Don't miss one of the few events dedicated exclusively to management accounting issues.

I hope you all have a healthy and profitable 2012. As always, feel free to forward a copy of this letter to anyone you believe might be interested (or at least amused).

Very truly yours,

Doug

Douglas T. Hicks, CPA, CMC
President



The Association for
Accountants and
Financial Professionals
in Business

*IMA Metro Detroit & Toledo Chapters' 2012 Spring Management Accounting
Conference:
Management Accounting's Role in Revitalizing US Manufacturing*

March 22, 2012

Topics & Speakers

- “Conceptual Framework of Managerial Costing” – Larry White, former IMA Chair, Director of the Resource Consumption Accounting Institute, and Chairman of the IMA's Managerial Costing Conceptual Framework Task Force. (75 minutes)
- “Resource Consumption Accounting” – Larry White, former IMA Chair, Director of the Resource Consumption Accounting Institute, and Chairman of the IMA's Managerial Costing Conceptual Framework Task Force. (75 minutes)
- “Understanding the Impact of Investment Costs on Productivity and Profitability” – Douglas T. Hicks, President, D. T. Hicks & Co. (50 minutes)
- “Lessons Learned from Autopsies of Failed Manufacturers” – Steve Martin, Director Transaction Services, BKD, LLP (50 minutes)
- “Enhancing the Bottom Line – A Mid-Sized Manufacturer's Success in Applying Activity-Based Concepts” – Jon A. Anderson, Vice President-Finance, Bosal North America & Douglas T. Hicks, President, D. T. Hicks & Co. (50 minutes)
- “Practical Applications of Cost Accounting in Sage X3 and Other ERP Systems” – Robert A. Abraham, Senior Consultant, Greenstone Professional Services (50 minutes)
- “All Speaker Question & Answer Forum” (50 minutes)

Conference Sponsored by...



GREENSTONE
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2012 Spring Management Accounting Conference
Management Accounting's Role in Revitalizing US Manufacturing
Metro Detroit/Toldeo Chapters - Institute of Management Accountants
Hotel Metropolitan - Romulus, Michigan
March 22, 2012

Session Schedule			
From	To	Description	CPE Hours
8:00a	8:30a	Registration	
8:30a	9:20a	"Understanding the Impact of Investment Costs on Productivity/Profitability" - Douglas T. Hicks, CPA, CMC, President, D. T. Hicks & Co.	1.0
9:20a	10:35a	"Conceptual Framework of Managerial Costing" - Larry White, former IMA Chair, Director of the Resource Consumption Accounting Institute, and Chairman of the IMA's Managerial Costing Conceptual Framework Task Force	1.5
10:35a	10:50a	Break	
10:50a	11:40a	"Lessons Learned from Autopsies of Failed Manufacturers" – Steve Martin, Director, Transaction Services, BKD, LLP	1.0
11:40a	12:30p	Lunch	
12:30p	1:20p	"Practical Applications of Cost Accounting in Sage X3 and other ERP Systems" - Robert A. Abraham, CPA, Senior Consultant, Greenstone Professional Services, Inc.	1.0
1:20p	2:35p	"Resource Consumption Accounting" - Larry White, former IMA Chair, Director of the Resource Consumption Accounting Institute, and Chairman of the IMA's Managerial Costing Conceptual Framework Task Force	1.5
2:35p	2:50p	Break	
2:50p	3:40p	"Enhancing the Bottom Line – A Mid-Sized Manufacturer's Success in Applying Activity-Based Concepts" – Jon A. Anderson, Vice President-Finance, Bosal North America & Douglas T. Hicks, President, D. T. Hicks & Co.	1.0
3:40p	4:30p	All-Speaker Rountable / Q&A Session / Close	<u>1.0</u>
4:30p	5:00p	Card exchange and networking	
Total CPE Hours			<u>8.0</u>

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Fee Schedule:

Category	Before 3/1/12	After 3/2/12
IMA Members	\$150	\$160
Non-IMA Members	\$170	\$180
Retirees/Unemployed	\$100	\$105
Students	\$80	\$80

Registration includes:
 * 8 hours of quality CPE
 * Continental breakfast
 * Lunch
 * Break snacks
 * Great networking

Register at : <https://www.123signup.com/event?id=cpqpt>