About Doug Hicks
President, D. T. Hicks & Co.

B.B.A. – University of Michigan – Dearborn 1970
C.P.A. – State of Michigan - 1972

Associations:
- Institute of Management Accountants
- Michigan Association of CPAs
- Society of Cost Management

Experience:
- Cost Management Consultant – 28 years
- Controller – 7 years
- Operations Auditor – 6 years

Published in periodicals including:
- Journal of Accountancy
- Management Accounting
- Journal of Cost Management
MANAGEMENT ACCOUNTING

Management accounting is the internal **business building role** of accounting and finance professionals who work inside organizations. These professionals are involved in designing and evaluating business processes, budgeting and forecasting, implementing and monitoring internal controls, and analyzing, synthesizing, and aggregating information – **to help drive economic value.**
There is, however, a “clutter” of competing ideas, viewpoints and perspectives in management accounting each claiming to be the exclusive purveyor of all of management accounting’s truth and wisdom.

*It’s like the ancient Indian tale of “The Blind Men and the Elephant”*
THE BLIND MEN AND THE ELEPHANT

It was six men of Indostan
To learning much inclined,
Who went to see the Elephant,
(Though all of them were blind),
That each by observation
Might satisfy his mind.

John Godfrey Saxe (1816-1887)
THE BLIND MEN AND THE ELEPHANT

- Its Side → “a wall”
- Its Tusk → “a spear”
- Its Trunk → “a snake”
- Its Ear → “a fan”
- Its Tail → “a rope”
- Its Leg → “a tree”
So oft in theologic wars,
The disputants, I ween,
Rail on in utter ignorance
Of what each other mean,
And prate about an Elephant
Not one of them has seen!

*John Godfrey Saxe (1816-1887)*
THE BLIND MANAGEMENT ACCOUNTANTS AND THE “ELEPHANT”

So oft in management accounting wars,
The disputants, I ween,
Rail on in utter ignorance
Of what each other mean,
And prate about an Elephant
Not one of them has seen!
THE MANAGEMENT ACCOUNTING

“ELEPHANT”

- Process Improvement & Lean Thinking
- Inventory Valuation & Cost of Goods Sold
- Capital Expenditure Evaluation
- Performance Measurement & Management
- Operational Planning & Budgeting
- Discrete Event Simulation - "What if?"/
- Design or Build-to-Order
- Outsourcing, Insourcing, Make/Buy
- Product Pricing and Profitability
- Strategic Planning & Analysis
- Supply Chain Management

© 2013 D. T. Hicks & Co.
VISUALIZATION AIDS THAT ENHANCE UNDERSTANDING

VS.

MECHANICAL PROCESSES THAT MUST BE METICULOUSLY FOLLOW

It is amazing to what lengths people will go to to avoid the process of thought.

– a sign in the office of Thomas A. Edison
VISUALIZATION AIDS

Monty Python’s 100-meter race for people with no sense of direction

Long-distance run on an oval track
VALUE-STREAM COSTING

All labor, machine, materials, support services, and facilities directly within the value stream. Little or no allocation.
STRATEGY MAPS

- Financial
  - Maximize Shareholder Value

- Customer
  - Exceed Customer Expectations
  - Inspire Loyalty

- Internal Business Processes
  - Create Quality Partnerships
  - Maximize Operational Effectiveness
  - Create High Quality Products

- Learning and Growth
  - Recruit Quality Staff
  - Train Employees
TOP TRENDS IN MANAGEMENT ACCOUNTING

Create cause-and-effect based cost models

Increase emphasis on predictive accounting

Incorporate economic costs into decision making

Replace annual budgets with rolling forecasts

Develop business analytics that encourage strategy execution
THE IMPORTANCE OF MODELS

• Most phenomena are too complex to be completely understood.

• People must function in a world where those phenomena exist and have an effect on their decisions and actions.

• To function effectively they create “models” of those phenomena.
THE IMPORTANCE OF MODELS

• Models represent an individual’s “internal version” of the outside world that makes that world more understandable and easier to deal with.
THE IMPORTANCE OF MODELS

“It is our models of phenomena that determine our behavior, not the phenomena themselves.”

Alfred Oxenfeldt
THE IMPORTANCE OF MODELS

• “The validity of our decisions depends on our perception and understanding of reality.

• Good decisions require good models,

• …and the caliber of our decisions reflects the quality and validity of our models.”
USE THE TRADITIONAL MODEL TO...

• Determine the cost of a purchased component or service
• Determine the benefit of creating a manufacturing cell to replace three independent operations
• Estimate (or measure) the cost of managing an exhibit while it’s on a multi-show, multi-state tour
• Compare the cost of acquiring business for each market served by the company

Does this model provide a valid “understanding and perception of reality?”
ACTIVITY-BASED CONCEPTS

Activity-based costing is a conceptual basis (or a “lens”) for creating an economic cost model of a business that will provide it with the accurate and relevant cost information it needs to support sound business decisions and actions of all types.

It’s purpose is insight, not numbers.
THE FUNDAMENTAL PRINCIPLE OF COST MODELING

• Products and services cause activities and those activities cause costs

• Associate costs with the activities that make them necessary and accumulated activity costs with the products or services that make them necessary

“The activity-based costing principle”
BASIC “ACTIVITY-BASED” COST MODEL

Activities → Costs

Product & Services → Costs

Support Activity Costs → Activity Costs

Costs → Incremental and/or Total Costs

“What if? Analyses

non-labor direct costs

assign

assign

assign

assign

Process/Activity Costs

Fully-Absorbed Costs & Rates

© 2013 D. T. Hicks & Co.
OXENFELDT’S RULE

“An error in measuring the magnitude of an effect usually is far less serious than mistakes due to wholly overlooked consequences.”

- Dr. Alfred R. Oxenfeldt
Three blindfolded runners are about to run a 220-yard race:

- Runner #1 does not know there are hurdles
- Runner #2 knows there are 36” hurdles – but only knows to within ±12” where they are
- Runner #3 knows there are 36” hurdles – and knows exactly where they are

Which runner is in “big trouble?”
The effectiveness of an activity-based costing model or system is more dependent on its design than on its method of implementation or the data used to populate the model or system.

“It is better to estimate the right things than to precisely measure the wrong things.”

“It is better to be approximately correct than to be precisely wrong.”
Variety Corporation Costs

Variety Corporation Cost Objectives
CATEGORIES OF COSTS/ACTIVITIES

• Throughput or Direct Costs
• Service and Operations Support Activities
• Throughput or Direct Cost Support Activities
• Direct or Value-Adding Activities
• Event or Transaction Activities
• Market or Customer Support Activities
• Product or Product Line Support Activities
• General and Administrative Activities
CATEGORIES OF COSTS/ACTIVITIES

Set-Ups/Changeovers
Production/Service Labor Time
Machine-, Cell- or Line-Time
In-Process Movement and Storage

Receipts
Orders
Line Items
Shipment/Delivery
Private Pay Billing
Resident Care Day
Admission/Discharge
Annual Assessment

Prod/Service Launch
Claims Analyzed
Batches Processed
Deposits – Paper
Deposits – ATM
Loan Closings
Overdrafts Honored
Electronic Payments
Variety Corporation Costs

Throughput or Direct Costs
- Throughput or Direct Cost Support Activities
  - Direct or Value-Adding Activities
    - Event or Transaction Activities
      - Market or Customer Support Activities
      - Product or Product Line Support Activities
      - General and Admin Activities

Variety Corporation Cost Objectives

© 2013 D. T. Hicks & Co.
PREDICTIVE ACCOUNTING

Trace costs to processes, products, services, customers, distribution channels, etc. based on cause-and-effect relationships

Project costs by process, product, service, customer, distribution channel, etc. based on cause-and-effect relationships

View of **the stern** of the ship

View of **the bow** of the ship

© 2013 D. T. Hicks & Co.
DESCRIPTIVE ASSIGNMENTS

Actual Production Labor Dollars

Actual Variable Electricity Cost

Actual Purchased Maintenance

Labor Hours per Machine Hour or Labor Reporting

Machine Hours or Metered Usage

Machine Hours or Requisitioned Use

Machine Cost

© 2013 D. T. Hicks & Co.
PREDICTIVE MEASUREMENTS

- Time per Carton
- Theoretical Labeling Labor Hours
  - Indirect Activity Allowance
    - Actual Labeling Labor Hours
      - Cost per Labor Hour
        - Actual Labeling Labor Dollars
  - Labeling Materials per Carton
    - Variable Purchased Maintenance

© 2013 D. T. Hicks & Co.
PREDICTIVE MEASUREMENTS

- Hours/Day By Category
  - Theoretical Nursing Hours
  - Indirect Activity Allowance
    - Actual Nursing Hours
  - Cost per Nursing Hour
    - Actual Nursing Labor Dollars

- Patient Count/Acuity
  - Laundry Units by Acuity Category
    - Laundry Units Consumed
    - Cost per Laundry Unit
      - Variable Laundry Cost
  - Dietary Units by Acuity Category
    - Dietary Units Consumed
    - Cost per Dietary Unit
      - Variable Dietary Cost

© 2013 D. T. Hicks & Co.
PREDICTIVE MEASUREMENTS

- Hours/Day By Category
- Theoretical Nursing Hours
  - Indirect Activity Allowance
    - Actual Nursing Hours
      - Cost per Nursing Hour
        - Actual Nursing Labor Dollars
- Patient Count/Acuity
  - Laundry Units by Acuity Category
    - Laundry Units Consumed
      - Cost per Laundry Unit
        - Variable Laundry Cost
- Dietary Units by Acuity Category
  - Dietary Units Consumed
    - Hours per Dietary Unit
      - Food Cost per Dietary Unit
        - Cost per Dietary Worker Hour
          - Variable Dietary Cost

© 2013 D. T. Hicks & Co.
WHY PREDICTIVE ACCOUNTING?

• To enhance the strategic planning process
• To improve short-, mid-, and long-term forecasting
• To facilitate elimination of the annual budgeting process
• To better support the decision making process
  • Short-term “incremental” decisions
  • Long-term “sustainable economics” decisions
THE DEADLY VIRUS OF GAAP

The Seven Deadly Strains

• Retroactive and Prospective Adjustments
• Investments vs. Expenses
• Unmade Expenditures
• Non-Annual Cost Cycles
• Volume & Mix
• Depreciation and Amortization
• Cost of Capital (or lack thereof)
RETROACTIVE / PROSPECTIVE ADJUSTMENTS

• Big Bang (or Creation) to Date & Now Until the End of Time Adjustments
INVESTMENTS OR EXPENSES?

• Research and Development
  – Sustaining vs. Growth

• Market Building Costs
  – Sustaining vs. Growth
UNMADE EXPENDITURES

- Research and Development
- Maintenance
- Market Sustaining Costs
NON-ANNUAL COST CYCLES

• Maintenance
• Marketing
• Product or Service Launch
VOLUME & MIX

- Prior Year’s Actual
- Current Year’s Budget/Plan
- Year of Performance Budget/Plan
- Practical/Attainable Capacity
Sunk Costs Are Irrelevant – No matter how you slice, dice or spread them, they’re still irrelevant.

Owners’ investment in a business is not “free money” – Leaving cost of capital out of the cost model results in measuring the micro different than the macro.
DEPRECIATION & COST OF CAPITAL

In depth discussion posted by the Society of Cost Management can be found at:

http://www.youtube.com/watch?v=9rSQN39oZWc&feature=youtu.be
PERFORMANCE vs. BUDGETS
What’s Broken About Budgeting?

• **Obsolete Budgeting** – obsolete with weeks after published

• **Bean-Counter Budgeting** – a fiscal exercise disconnected from strategy

• **Political Budgeting** – “don’t get me fired because of a budget”

• **Over-scrutinized Budgeting** – constantly reconciling old budgets to revised budgets
PERFORMANCE vs. BUDGETS

What’s Broken About Budgeting?

• **Sandbagging Budgeting** – savvy managers sandbag budgets that roll up into one giant sandbag

• **Blow-it-all Budgeting** – “use it or lose it”

• **Wasteful Budgeting** – waste not identified; inefficiencies from one year “baked into” the following year’s budget
DRIVER-BASED BUDGETING

Budget Period Fixed Expenses
- Leases
- Depreciation
- Property Taxes
- Insurance

Volume-Driven Expenses
- Manpower
- Utilities and Supplies
- Equipment Maintenance
- Payroll Taxes/Benefits

Strategic Project Expenses
- Product/Service Launch
- Strategic Capital
- Market Building
- Research & Development

Discretionary Expenses
- Advertising
- Upgrade Capital
- Travel & Entertainment
- Conference Participation

Driver-Based Budget Model

© 2013 D. T. Hicks & Co.
### DRIVER-BASED BUDGETING

#### Budget Period Fixed Expenses
- Leases
- Depreciation
- Property Taxes
- Insurance

#### Volume-Driven Expenses
- Manpower
- Utilities and Supplies
- Equipment Maintenance
- Payroll Taxes/Benefits

#### Strategic Project Expenses
- Product/Service Launch
- Strategic Capital
- Market Building
- Research & Development

#### Discretionary Expenses
- Advertising
- Upgrade Capital
- Travel & Entertainment
- Conference Participation

---

**Driver-Based Budget Model**

- Not much can be done in short-term
- Cost per hour, unit or other volume measure make costs automatically variable
- Timing or wisdom of strategic initiatives can be reevaluated in short/mid-term
- Can be eliminated or postponed in short-term

---

© 2013 D. T. Hicks & Co.
DRIVER-BASED BUDGETING

• Ensures realistic budgeting – budgeting that doesn’t “violate the laws of physics

• Provides the basis for rolling forecasts / continuous budgeting and planning with cycle reviews of elements of “strategic project expenses” and “discretionary expense”
  • Facilitate elimination of annual budgeting process

• Provides the basis for flexible spending budgets based on actual volume and mix of business
FAILURE TO IMPLEMENT STRATEGY

9 out of 10 Companies Fail to Implement Their Business Strategies.

…. Kaplan & Norton
EXECUTIVES ARE MOST CONCERNED ABOUT EXECUTING STRATEGY

"Using a 1-5 scale, please rate the level of interest / concern you have in the following business issues at present."

- Executing the strategy: 4.0
- Regulatory, compliance, and risk management: 3.8
- Market trends: 3.7
- Customer service: 3.7
- Forecasting & reporting effectiveness: 3.7
- Growing the top line: 3.7
- IT capabilities: 3.5

Source: 2006 Monitor Analysis. Survey of 354 executives; 49% of respondents are C-level and 56% are from companies with revenue greater than $1 billion
EXECUTING THE COMPANY’S STRATEGY

Vision & Mission

Where does the company want to go?

Strategy Map

How does the company plan to get there?

Balanced Scorecard

How effectively is the company executing the plan to get there?

These are mechanical devices designed to help realize the Vision and Mission
Maximize Shareholder Value

Financial

Customer

Internal Processes

Learning & Innovation

Copyright 2012  www.garycokins.com
Analytics-Based Performance Management LLC
STRATEGY MAPS

**Financial**
How much value does the organization need to create to satisfy its shareholders/owners?

**Customer**
What is the organization’s value proposition to its customers?

**Internal Process**
How will the organization efficiently and effectively deliver the customer value proposition?

**Learning**
How will the organization enable its employees to perform the necessary strategic processes?
STRAATEGY MAPS

Increase Revenues
Increase Productivity
Decrease Costs

Customer Intimacy
Operational Excellence
Product Leadership

Customer Processes
Innovation Processes
Operational Processes
Regulatory/Social Processes

Human Capital
Organization Capital

© 2013 D. T. Hicks & Co.
THE KEY TO SCORECARDS

How does everyone answer this single question:

“How am I doing on what is important?”

Strategy Maps and Scorecards provide this answer.

The overriding purpose of a strategy map and scorecard system is to make mission and strategy everyone’s job.

Copyright 2012  www.garycokins.com

Analytics-Based Performance Management LLC
WHAT IS THE DIFFERENCE BETWEEN KPIs & PIs?

**Strategy Diagram**
- KPIs: (strategic context)
  - With targets
  - Without targets
- Measurements
  - drill-down analysis
  - alert messages
- Scorecard
  - Project-based KPIs
  - Process-based KPIs
- Dashboard
  - Budget & Resource Planning
  - Frequency of reporting: quarterly, monthly, weekly, daily, hourly, real-time

**WHAT IS THE DIFFERENCE BETWEEN KPIs & PIs?**

- **KPIs**: (strategic context)
  - Must have targets
  - Without targets
- **PIs**: (operational)
  - With targets: - Trends - Upper / lower thresholds
  - Without targets
Douglas T. Hicks, CPA

Douglas T. Hicks, CPA is President of D. T. Hicks & Co., a consulting organization concentrating on the decision costing needs of small and mid-sized organizations. Before establishing his firm in 1985, he accumulated over fifteen years of financial and management accounting experience, twelve of those years in industry. A graduate of the University of Michigan - Dearborn’s School of Management, he is a member of the Michigan Association of CPAs, the Institute of Management Accountants, and the Society of Cost Management. In 1997, he was presented with the University of Michigan – Dearborn Alumni Association’s Professional Growth and Scholarship Award in recognition of his work in the development of advanced cost measurement and management.

Since 1985, Doug has worked with over two hundred businesses to develop cost-effective ways to improve the cost and other management information they rely on in making both strategic and day-to-day decisions. These client organizations have ranged from $2 million to over $500 million in annual sales and have included firms in health care, distribution, printing, packaging, marketing services, and other service sectors as well as automotive, aerospace, office equipment, furniture, and other manufacturers.

This work has resulted in the "abc" solution™, an “activity-based” decision support process, originally designed for small and mid-sized organizations, but one that has proven to be effective for larger organizations as well. Using the “abc” solution™, businesses are able to develop the accurate and relevant cost information they need to make effective product pricing, product line management, investment, cost reduction, and other critical decisions.

As Doug’s down-to-earth approach to cost and performance measurement and management issues has become more widely known and accepted, he has become a popular speaker on the subjects. Many trade, accounting and other professional associations have used him as a resource for their members including the Institute of Management Accountants (IMA) and Michigan Association of CPAs (MACPA) for whom he has been a regular speaker and educator for two decades. He has spoken at over 100 MACPA conferences and seminars and, in addition to speaking at scores of local IMA Chapter and regional meetings, he was a featured speaker at the IMA’s 1993, 1994, 1996, 1998, 2005 and 2007 annual conferences. In 1998, he was chosen by conference and seminar participants as the IMA’s “Instructor of the Year.”

Doug has authored scores of articles that have been published in a wide variety of professional and trade magazines including Journal of Accountancy, ActionLine, Manufacturing Engineering, Journal of Cost Management, Modern Casting, Plastic Technology, Michigan CPA, Internal Auditor, Precision, and Management Accounting. His first two books, Activity-Based Costing for Small and Mid-Sized Businesses: An Implementation Guide and Activity-Based Costing: Making it Work for Small and Mid-Sized Companies (both published by John Wiley & Sons) have sold over 15,000 copies worldwide and have been translated into four languages. His most recent book, I May Be Wrong, But I Doubt It: How Accounting Information Undermines Profitability is available at www.lulu.com and www.amazon.com.