LEAN ACCOUNTING

Those of us involved in manufacturing in the Western World realize that for the most part, we are operating on a burning platform. To compete in the global economy we must transform our companies to world-class status. The operational strategy that has proven most effective in achieving world-class performance levels is Lean. The seminal book, *Lean Thinkin*g, by James Womack and Dan Jones, coined the term Lean as a methodology to eliminate waste in any type of company, functional area, process, or activity.[1] The phrase "Lean Manufacturing" has generally referred to the process of creating a Lean organization. However, using the term "Lean Manufacturing" may have created one of the biggest impediments to the Lean conversion process by advertising Lean as strictly a manufacturing initiative that does not apply to the rest of the company. As a result, the non-manufacturing functional areas of a company have typically adopted a hands-off attitude towards Lean activities.

Early successful Lean practitioners, such as Toyota, Wiremold, Lantech, Zara, Danaher, and HNI, realized a Lean conversion was a total company effort. Other companies have floundered in their Lean implementations by concentrating all of their efforts on the shop floor with little or no participation by the rest of the company. Lean manufacturing is now well entrenched across the world. However, other areas such as Lean Product Development, Lean Accounting, Lean Sales, Lean Customer Service, and Lean Human Resources have a considerable way to go. It is only in the last few years that companies have realized that Lean is all about a Lean enterprise effort, requiring the full participation and support of the entire organization.

Accounting can represent a major obstacle to an effective Lean conversion. Accountants typically do not fully understand Lean, have difficulty supporting it, are unsure how to measure Lean improvements, are often challenged finding time to devote to it, and generally have not been asked to participate in Lean activities that usually focus exclusively on the shop floor. In order to compete successfully on a global basis, accounting and every other functional area must be a major contributor and participant in the Lean journey. Referring to Lean as a Lean Enterprise recognizes that success is dependent on a total company commitment across all functional areas, integrated from the top to the bottom of the organization.

Lean Accounting

It has become common practice to use the terms Lean accounting and Accounting for Lean interchangeably even though there is a significant difference between the two concepts. Lean accounting is no different than Lean manufacturing in that Lean tools are utilized to eliminate waste in the accounting function; whereas accounting for Lean represents an accounting system that captures the benefits of a Lean implementation as well as motivates Lean behavior.

Lean Accounting is defined as:

- **An accounting system that utilizes the Lean tool kit to minimize the consumption of resources that add no value to a product or service in the eyes of the customer.**

- **A discipline focused on providing *actionable information* to users and eliminating transactions, reports, and historical data collection.**

- **A department of *financial advisors* to a series of focused factories, along with associates who are *involved in the day-to-day activities* of all areas of the company, and are willing to work in the plant and participate in kaizens.**

- **An accounting department whose lean efforts are fully compliant with GAAP and all internal and external reporting requirements.**

This definition of Lean accounting includes the elimination of waste by utilizing the Lean tool kit and adds a number of other dimensions as well. Accounting departments have mainly focused their efforts on presenting historical information. A Lean accounting organization provides value-added analysis to its customers in a very simple manner so that improvement actions can be taken immediately. Furthermore, accountants actively participating in these improvement activities have a much greater understanding of the underlying processes. This new perspective promotes accountants from strictly historical reporters and clerical bookkeepers to navigators, or mini CFO's for the organization's various value streams.

Accounting for Lean

As an organization transitions from traditional manufacturing encompassing batch processing to Lean manufacturing where pull and flow are the norm, traditional cost accounting methods developed in the early twentieth century become irrelevant The old batch and queue environment with large lot sizes, long set-ups, massive inventories, and a push production system required extensive control points, detailed job tracking, and sophisticated cost allocation routines, which unfortunately were usually incorrect, outdated, and undecipherable for most of the organization.

In a Lean manufacturing environment, product is quickly pulled through the plant via one-piece flow, inventory levels are minimized as well as standardized, skilled labor operates multiple machines simultaneously, water spiders rotate into skilled positions as needed, and generic materials are used to provide greater flexibility and standardization. The overall speed of the operation is many orders of magnitude greater than a batch operation. In this environment, the traditional standard cost system and absorption accounting are not only ineffective, but may become a significant barrier to a successful Lean conversion.

Accounting for Lean is defined as:

- **An accounting system that provides accurate, timely, and *understandable* information to motivate the Lean transformation throughout the organization and improve decision-making, which leads to increased customer value, growth, profitability, and cash flow.**

- **An accounting system that supports the lean transformation by providing relevant and actionable information that enables continuous improvement at every level of the organization.**

- **An accounting system that utilizes value stream costing, "Plain English" profit-and-loss statements, box scores, and other straightforward means to convey performance activity.**

- **An accounting system that meets the needs of *all* of its customers, including tax authorities, the Board of Directors, creditors, internal and external auditors, and *internal customers such as manufacturing*.**

As both the definition of Lean accounting and accounting for Lean demonstrate, under no circumstance will adherence to reporting requirements by regulatory agencies such as the SEC, IRS, and GAAP be compromised.

Accounting for Lean is twenty-first century cost management in support of world-class operations. The accounting department is in the unique position of having to do two things during the Lean conversion process: (1) apply Lean tools to eliminate waste in the accounting department; and more importantly, (2) change the overall method of keeping score for the internal operations of the business. The latter task is daunting, but nevertheless, one that has to be completed for a successful Lean conversion. Given this challenge, it is easy to see why accounting department resources will be stretched during a Lean conversion.

The ideal Lean accounting progression should begin very early in the Lean journey with the accounting staff participating in the events taking place on the manufacturing floor. Enlightened accounting leadership should then immediately deploy the same tools in the accounting department to eliminate waste and all of the non-value-added clerical work that is too often all consuming. By following this path, when the time comes to implement accounting for Lean, accountants will not only understand what has taken place in production, but they will also have the knowledge, time, and resources necessary to devote to the change process.

1. James P. Womack and Daniel T. Jones. *Lean Thinking*, (New York: Simon & Schuster, 1996).