

The Auditor's Encroaching Elephant

As an auditor, you probably offer “value add” services to your client manufacturing companies. There is traditionally a sound basis to this offer. You're in a variety of companies and can see and pass on a variety of best practices. And, since there are many members in the CPA firm that are auditing, you share best practices, and, thereby, increase the web of best practices exponentially. Not to mention, the experience of similar auditing practices for many, many years to draw on. Now, what if a significant change is underway that doesn't fit that experience? What if there is an unnoticed elephant pushing its way into the room?

And, the elephant question of the day is, “How will you add value to your clients who join the growing mass of very non-traditional lean manufacturers?”

The Elephant Surprise

What if the client as embarked on a dramatic new business strategy or approach with which the auditors are unfamiliar? And, what if the new business strategy is so powerful that it creates a furor of change in the processes, organizational structure, and manufacturing practices resulting in dramatically different utilization of capital and levels of profitability?

Are you and your firm ready to partner with and effectively audit a lean company? Do you want to have to corral this elephant unprepared?

What if the change is so rapid that comparing the results to a 12 month old budget or to prior year results provides variances so large as to be meaningless? Or, what if the levels of inventory has dropped so much that the focus on inventory valuation has completely changed in importance? Or, what if the means of purchasing materials has made many of the old controls obsolete?

What would you do? Would you believe it could be true? More importantly, can you absorb that much change with your typical staff of recent accounting graduates managed by a third-year and overseen by a partner? Would the audit get done on schedule? Could you meet your schedules? Would you have audited results for tax filing?

Have you encountered your first lean company yet, and, if so, are you presently struggling with the changes and still adding value to that client? Is the elephant getting outraged?

Even the most experienced CPA firms and auditors would be challenged by the above scenarios. A big task! This is especially so if it is an unexpected surprise.

Whither Yon Elephant

The changes alluded to above are not at all unusual in companies who are adopting the Toyota Production System, commonly referred to outside of Toyota, as lean manufacturing or just “lean”. Lean is a set of principles and workaround tools that when applied to any process—that’s ANY process—add to customer value through better work flow while minimizing waste and being flexible with the ability to change according to customer demand. Lean efforts lead to efficiency gains, lower costs, and better delivery times. This ongoing application of lean is often referred to as the company’s or individual’s “lean journey”.

Lean, like finance and accounting, has some unique technical lingo. If your staff has a blank stare when they hear terms like “kanban”, “muda”, “kaizen” or “5S”, they will be rapidly discounted by their lean clients as the lingo becomes part of the fabric of daily activity at the client site.

Also, while Lean has primarily been adopted by manufacturers around the world over the past decade, today many in the healthcare industry are turning to lean principles to rid their organizations of waste. Other sectors with notable lean activity currently include construction, retail, and finance.

Further, some of the most innovative companies such as Boeing, Kimberly-Clark, EMC, Raytheon, and many smaller firms are now applying these same lean principles to processes beyond manufacturing, ultimately resulting in a “lean enterprise” where every process is potentially subjected to lean principles.

Of particular importance to the auditor is when a company decides to adopt lean accounting to better support the lean enterprise. Lean accounting often eliminates standard cost accounting all together while maintaining full GAAP compliance, but, as you might guess, the reporting structure is dramatically changed. Auditors must understand the fundamental lean basis of these changes in order to engage their clients effectively. This is capturing the elephant’s heart and soul.

Elephant Friend or Foe

When the auditors directly participate in the adoption of lean by acquiring lean knowledge and being available for questions and feedback, it raises a company’s odds of lean success dramatically for two reasons. First, the barrier of “The auditors said...” or more recently “Sarbanes-Oxley won’t let us do that.” is eliminated since a call to a lean-centric auditor will quickly provide an educated, compliant solution to most questions. Second, when the auditors see dramatic changes (i.e. a sudden 30% reduction in inventory) especially during the early stages of lean, they will not inadvertently spend a lot of time trying to figure out the “problem” when it may well be a very positive company goal!

Some companies have established regular quarterly meetings with their auditor to enable two-way communications of changes in their company as well as new developments in the audit profession. When an auditor is seen as an extension of the staff, everyone wins. The elephant is becoming an asset.

To get engaged with your client's lean efforts as soon as possible, ask them if they are planning on adopting lean production and are they considering converting to lean accounting. And, if so, how might you best partner with them to support the effort? The dynamics of your relationship with your clients do not allow for surprises. If you wait until the annual audit starts and are not prepared to address the vast array of changes made during a year of lean transformation, you can be guaranteed that the audit will be long and arduous. At the pace of change of most lean transformations, it is far too much to absorb all at once. And if the timelines cannot be met for the audit schedule because of so much explanation, then tempers can flare, the listening stops, and frustration builds — the last things you want to happen during the audit!

When I was CFO at Lantech, our quarterly meetings included not only meeting time in a conference room, but also a walk around on the shop floor to visually show what had changed through our lean initiatives that might have impact on reporting. This walk always saved several thousand words of explanation as to why the changes were needed and why they made our company stronger.

Elephant Assets

To address and understand this fundamental change in how companies operate, you should develop a strategy to corral this elephant one banana at a time. First, take steps to educate your audit staff and partners—especially those focusing on manufacturing clients. They should learn what lean is and the changes they should expect to see in lean companies?

There are a number of ways for auditors to start their lean journey. First, read some lean books. There are many and some of my favorites for starting out are *Lean Thinking*, *The New Manufacturing Challenge*, and *Real Numbers* (which I co-authored). Or you can do some web surfing....there are an amazing variety of articles out there.

An essential way to expand your depth and breadth is to attend conferences or workshops. The Association of Manufacturing Excellence (AME) has ongoing regional workshops about lean topics. AME's annual conference has a huge number of speakers from lean practitioners and tours of lean companies. Another conference on lean and its specific impact on accounting is the Lean Accounting Summit (LAS) held annually in September. At LAS, accounting and finance people gather to hear speakers discuss their experiences with lean, the role for finance and accounting to support an evolving lean enterprise, and lean accounting case studies.

Because I believe so passionately on the importance of the CPA and auditor understanding lean going forward, my firm has developed a one-day workshop specifically for auditors who want to learn about lean, lean accounting, and the impact to the audit plan. As a special addition, we

also have a case study of a CPA firm that has applied lean to their own internal processes for productivity and quality gains.

Both auditing firms and individual CPAs need to avoid ignoring the elephant. The results of that are not pretty! Strategize now on training staff and partnering with client companies on how best to further their lean efforts. Lean is an elephant well past critical mass, is getting larger quickly, and can be a very difficult foe. But, with a few well placed bananas, you can quickly turn it into a surprisingly valuable asset.

Good luck on your lean journey.

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In addition to providing public seminars and leading Lean events for clients, Jean is the CFO for Stiles Associates and the Association of Manufacturing Excellence. She was previously the CFO at Lantech and Marshfield Door Systems. She has a BS in Accounting from Indiana University and an MBA from Northeastern University's Executive Program. She and her family reside in the Chicago area.