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"Education is learning what you didn't even know you didn't know."
- Daniel Boorstin

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Dear Executive:

Last week I received my Medicare card. Although it doesn't go into effect for a few months, I believe it is a valid indication that I am no longer a third-class curmudgeon, but can now consider myself a second-class curmudgeon (it'll be several more years and another score or two of "rants" before I can even dream of first-class status). As a result, I thought I'd double up on my rants and present a couple of analogies in this quarter's letter: one describes how accurate and relevant decision costing information has proven to be an "Invisible Gorilla" for most accountants and the other discusses the similarities I've found between many of today's CEOs and the celebrated survivor and story teller Scheherazade.

The Invisible Gorilla

In an experiment described in the book "The Invisible Gorilla," volunteers were shown a video of young people tossing a basketball around and were told to keep track of how many times a basketball was passed between players wearing white shirts. Half way into the video, a person dressed in a gorilla suit entered the field of view, turned to face the camera, beat on his chest, and then walked out. Only about half of the volunteers noticed the gorilla. In fact, those in the half that didn't notice the gorilla were confident in their belief that no such gorilla had ever appeared. This invisible gorilla experiment highlights a phenomenon called "inattentional blindness" – how paying close attention to one thing can cause an individual to totally overlook other things, even if those other things are obvious.

More recently, researchers at Brigham and Women's Hospital asked a group of twenty-four experienced radiologists to identify white nodules within five CT scans made up of hundreds of images of lung tissue – a process used to identify potential lung cancer. In one of the scans, the researchers inserted an image of a gorilla almost 50 times the size of a nodule. Despite its large size and incongruous presence, only four of the 24 radiologists noticed the gorilla. Failure to notice the gorilla was not because it was difficult to see – eye-tracking data showed clearly that all the radiologists looked right at the gorilla – they were just paying close attention to something else. The experiment was later repeated with untrained volunteers and none of them noticed the gorilla.

For nearly three decades, the negative impact of traditional cost accounting information on executive decision making has been clearly documented and 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 here in 2013, a vast majority of organizations continue to use over-simple and outdated costs models that provide their decision makers with an irrational jumble of nonsense – disguised as accurate cost information – as support for making decisions critical to the survival and growth of their organizations. Could it be that the inaccuracy and irrelevance of traditionally measured cost information is simply "an invisible gorilla" to the accountants that generate that information?

An ever more complex business world continually burdens accountants with more and more financial reporting, regulatory compliance and financial administration responsibilities. The pressure from management is not for the accountants to provide them with accurate and relevant decision support information, but instead to "keep them out of trouble," create convincing analyses that help them keep their jobs, and provide the traditional reports demanded by "higher-ups," owners, banks and government agencies. These ever-growing responsibilities have ballooned to become the accountants "white-shirted basketball passers" and "white nodules." The "inattentional blindness" resulting from all these extra value-preserving – but non-value-adding – responsibilities provides accountants with a plausible reason for failing to address the decades old problem of inaccurate and misleading cost information. However, after three decades, this plausible reason has become just a really lame excuse.

I concluded my 2008 book, "*I May Be Wrong, But I Doubt It: How Accounting Information Undermines Profitability*," with a chapter suggesting that accountants be banned from touching a company's cost information (it was also the topic of my Summer 2009 executive letter). The reason is simple: individuals attracted to accounting thrive in a world of "man-made laws, rules and regulations" – the bureaucratic complexities that must be followed for an organization to survive in an ever more complex world. Cost measurement, decision science and managerial economics are not driven by rules and regulations. Instead, they are disciplines driven by "laws of nature" that require the careful crafting of fundamental principles to fit a specific and unique set of circumstances. The only "rule or regulation" is to match economic reality as close as possible, but no closer than necessary. Perhaps it is only natural that accountants deluged by things they are good at and like to do find it difficult to see an invisible gorilla in which they have little interest or aptitude. It's certainly not because there has been no attention drawn to the problem.

There are, of course, accountants who are competent at dealing with both laws of man and laws of nature, but after working with accounting professionals for more than four decades, I've found that group to be a very small minority indeed. I should add that I am not a member of that group. I freely acknowledge that I am not interested in, don't care about, or have competence with the "laws of man" that drive accounting. If more accountants would admit the same about cost measurement and management, we'd all be better off.

The Scheherazade Syndrome

While driving home the other night I was listening to Nikolai Rimsy-Korsakov's symphonic suite *Scheherazade* on my car radio. As I drove on, I recalled the story of Scherherazade from my reading of Sir Richard Francis Burton's "The Book of the Thousand Nights and a Night" and it occurred to me that her approach to dealing with king Shahryar was the same as the approach many CEOs use when dealing with those who hold the power to either reward or dismiss them.

To refresh your memory, the story goes that every day Shahryar the king would marry a new virgin and every day he would send yesterday's wife to be beheaded. This was done in anger, having found out that his first wife was unfaithful to him. He had killed one thousand such women by the time he was introduced to Scheherazade, the vizier's daughter.

Against her father's wishes, Scheherazade volunteered to spend one night with the King. Once in the King's chambers, Scheherazade asked if she might bid one last farewell to her beloved sister, Dinazade, who had secretly been prepared to ask Scheherazade to tell a story during the long night. The King lay awake and listened with awe as Scheherazade told her first story. The night passed by, and Scheherazade stopped in the middle of the story. The King asked her to finish, but Scheherazade said there was not time, as dawn was breaking. As a result, the King spared her life for one day to finish the story the next night. The next night, Scheherazade finished the story and then began a second, even more exciting tale which she again stopped halfway through at dawn. The King again spared her life for one day to finish the second story. And so, the King kept Scheherazade alive, one night at a time, for a thousand nights as he eagerly anticipated her finishing of the previous night's story.

Does this sound familiar to anyone? A CEO gets hired by investors to run an organization they purchased with the intention of selling it at a substantial profit in the not too distant future. To turn that future profit, the investors establish certain metrics to serve as targets the CEO must meet in order for the company's apparent worth to increase to the necessary levels. Sometimes those targets "violate the laws of physics" and sometimes they do not. At predetermined intervals, usually each month or each quarter, the CEO must report progress against those targets. If targets are met or exceeded, the CEO remains employed. If they are not, the CEO's continued employment is jeopardized. Too many intervals with targets that are not met and our CEO is let go and a new one hired.

The CEO likes his or her prestigious, high-paying job and so does everything possible to make sure those periodic targets are met – even when meeting them jeopardizes the company's ability to meet its targets in the future. After all, if you don't hit this period's numbers you might not be around to worry about the next period's numbers. The CEO's primary objective is his or her survival, not the long-term health and prosperity of the organization.

A long-time CFO/friend of mine recently told me of a conversation he had with the CEO of a mid-size to large (over 1,000 employees in a dozen facilities) auto supplier owned by a private equity firm. My CFO/friend was very familiar with both the CEO's company and his CFO. The company's accounting organization focused entirely on financial reporting – there was no effort to develop sound economic information on which management could base its decisions – and even the financial systems were archaic and inconsistent from location to location. Since both the CEO and CFO arrived at the company, there had been no effort to upgrade the accounting system or develop accurate and relevant information on which the company's managers could base their decisions. In short, the company operated almost exactly like the one Gary Cokins described in his blog "Rule for Assuring Poor Performance" (which you can still find at http://www.information-management.com/news/10000124-1.html) back in 2007.

When my CFO/friend asked, "Why do you put up with a CFO that presides over such an inept accounting function and provides you and your managers with little or no information of value?" the CEO replied, "Oh, he does provide with me value. Every quarter he puts together a six-inch thick book that I take to my meeting with the private equity firm's board that enables me to either answer or dance around their questions and helps me keep my job for another quarter."

I don't know about you, but I find such an attitude depressing. Unfortunately, I've also found it quite widespread among C-level executives who don't plan on being around for more than three to five years and who care little about the long-term prospects of their employees or the communities in which their facilities are located. It's all about telling a tale that will induce the king into keeping them alive for one more day – *The Scheherazade Syndrome*. During my twenty-eight years as a consultant, I can think of a half dozen CEOs (not necessarily clients) who've managed to play Scheherazade at two to four different companies – never leaving the company in better shape than when they became CEO (and sometimes leaving as it went bankrupt), but finding another "king" to hire them and listen to their stories for three or four years before sending them to the executioner. How sad.

Metro Detroit IMA's Spring Management Accounting Conference

On March 21st, the Metro Detroit Chapter of the Institute of Management Accountants held its 7th Annual Spring Management Accounting Conference. The session was titled "21st Century Financial Planning & Analysis: The Difference Between an Accountant and a Management Accountant." Gary Cokins joined (and probably carried) me in presenting the day long event which attracted a record crowd and received excellent reviews. As was the case in 2012, the conference was sponsored by Greenstone Professional Services whose website you can check out at: http://www.greenstonepros.com/.

We've already begun planning next year's event which is scheduled for March 20th and, like this years conference, will be at the Sheraton Hotel next to Detroit's Metropolitan Airport. As has been the case with all previous spring conferences, the subject matter will be exclusively management accounting, no financial accounting or compliance issues will be included. If you're looking for 8 CPE hours of quality management accounting education, mark the date and plan on being with us. More information on the conference content will be coming in future letters.

I hope you've all gotten off to a great start in 2013. As always, I look forward to hearing from any of you who have questions or comments regarding this quarter's letter and you should feel free to forward a copy to anyone you believe might be interested (or at least mildly amused).

Very truly yours,

Doug

Douglas T. Hicks, CPA
President