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POOGI #56: We are continuing our series based on [The Goal](#) by Eliyahu M Goldratt and the [Theory of Constraints](#). {This series was co-written with [Brad Stillahn](#)}

Cost accounting is alive and well in American business (and around the world really), even though it is an invalid, old technology. The continued and unquestioned use of cost accounting has led directly to the loss of competitiveness and long-term decline of American manufacturing. Stop using it!

Brad: You give a lot of speeches to business owners. Tell me again, what drives you nuts?

Dr. Lisa: When someone says "We lost money on that job" or "We lost money on that project".

Brad: That's cost accounting talking. It's amazing the owner is still in business, saying something like that. If his competition didn't all think the same way, he would be out of business.

Dr. Lisa: Truly variable costs-materials, outsourcing, freight, sales commissions-are normally just a fraction of the selling price. There are only two ways to lose money on a job: 1) charge less than your truly variable costs; or 2) re-work a job over and over again causing you to incur the truly variable costs multiple times and the total of all the truly variable costs are more than the price you charged.

Brad: The all-industry average for truly variable costs (TVCs) is 40%.

And machine shops are usually much less than that, depending on the type of work they do. So why does the business owner think he "lost money on that job"?

Dr. Lisa: It's the allocation of overhead cost, the number one conceptual mistake of cost accounting. Remember, cost accounting was invented back at the turn of the last century, when labor was paid piece rates and overhead was less than 10% of total costs.

What really happened was that the job took more time than estimated. And since cost accounting allocates "cost" to that time, the job "cost" more than expected, perhaps more than the price. But this is a mirage. The margin received - the sales price minus the truly variable costs - is the same no matter how long the job took to produce.

... to be continued.

Here's to maximizing YOUR profits!

Dr Lisa

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