Strategic Cost Analysis
for Program and Project Management

Making smart project and business choices

Using accounting-based strategies to control costs, improve performance, justify project outcomes, and create value for the organization

An Intensive Two-Day Program for Senior Program and Project Managers

in Cambridge, Massachusetts
November 16-17, 2009
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http://mitsloan.mit.edu/execed

INSIDE: Earn an MIT Sloan Executive Certificate
As a program or project manager, your understanding of costs is critical to the success of both product development and technical projects.

Yet many technical and general project managers do not have a working knowledge of accounting or the cost analysis skills that are necessary to make good project decisions.

At the MIT Sloan School of Management much of the teaching and research of our award-winning Accounting Group focuses on issues that are relevant to the challenges that project and program managers face.

This program is about how to do the financial analysis of projects.

It offers a unique opportunity for you to learn cost accounting-based project management practices and strategies for making smart project choices which justify project outcomes and create project value.

Strategic Cost Analysis for Program and Project Management is drawn from our popular and highly-rated MBA courses on financial and managerial accounting and shows how you can leverage cost analysis to better influence the outcomes of product development and project management.

Led by Professor Joseph Weber, the head of the MIT Sloan Accounting Group, and Senior Lecturer Scott Keating, the program offers a series of interactive lectures, cases, and small group exercises that will help you to better understand:

- the language and mechanics of the accounting that goes on in complex organizations
- how to identify good results even though the accounting numbers look bad, and bad results when the accounting numbers look good
- cost allocations, absorption costing, and transfer pricing, and their effect on reported performance
- your own company’s internal metrics for evaluating management

Who Should Attend

This program has been developed for senior program and project managers from a wide range of consumer and business-to-business industries, including those from engineering, manufacturing, IT and technology departments, directors of project management, product and business development, and R&D, chief project engineers, product design and process development engineers, and key members of their staff with performance responsibility.
This program has been designed to take the mystery out of accounting and costs. By the end of the program you will better understand:

**The Language of Accounting**
- Assets, liabilities, and shareholders equity
- Accounting revenues and expenses (and how they differ from economic revenues and expenses)
- Operating cash flows, investing cash flows, and financing cash flows
- Accruals

**Internal Accounting**
- Why firms produce profit & loss statements for evaluating business units
- Cost allocations that spread costs across business units
- Methods of assigning costs to products, services or activities
- The pricing of goods or services exchanged between business units

**Project Financing Analysis and Evaluation**
- How long term project proposals are best evaluated
- Choosing among projects when funding is scarce

**Performance Measurement and Management**
- Net present value, internal rate of return, payback, and economic value analysis
- How to evaluate and determine the viability of existing projects

**About the MIT Sloan School Executive Series on Management, Innovation, & Technology**

The impact of technology on the corporation is being felt not only in terms of the products, processes, and services companies are able to design and market, but in the way organizations are being restructured and managed.

For senior technical and corporate executives, staying abreast of the competition means staying abreast of the way technology is redefining the corporation.

This is one in a series of interactive, executive-level programs that have been designed to help both technical and non-technical management succeed in an environment of accelerating technological change.
1. **An Introduction to Strategic Cost Analysis: Reviewing Basic Accounting Concepts**

This session provides participants with a common language platform, so you understand, in accounting terms, what we mean when we discuss:

**Basic accounting concepts, including:**

- assets, liabilities, equities, revenues and expenses
- Generally Accepted Accounting Principles (GAAP), including
  - the difference between accrual accounting and cash accounting
  - why accrual accounting is often more useful in forecasting future cash flows
  - what accrual accounting can and can not be used for
- internal auditing and oversight: the controls that safeguard a firm's assets

**Basic financial statements** such as income statements, balance sheets, and statements of cash flow, and:

- how these statements can be used to diagnose and run your business
- how different transactions (risks) impact various elements of the firm's financial performance

2. **Cost Accounting: The Mechanics of Cost Allocations and Transfer Pricing**

Participants move into a more detailed discussion of internal accounting practices used by large organizations to monitor, invest in, and evaluate projects. If you are a project manager, this is the sort of information your boss is looking at and your company uses to keep track of how your project is or is not working.

In this introduction to cost allocations, we describe the mechanics of typical cost allocations; where and how cost allocations are used in organizations; and similarities and differences between cost allocations and transfer pricing.

In particular, we focus on cost allocations in several contexts:

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### Case: Reinforcing Basic Accounting Concepts

Participants work in small groups on a case that builds on the financial accounting language developed in the initial part of the program. Based on a small business, the case calls for you to prepare a cost analysis to determine whether the business is making money from an accounting perspective, is working well from a business perspective, is generating good returns, and where it is succeeding and failing.

Issues are raised about how you measure the performance of a project, an organization, a company, or any business entity, leading to a discussion of what you can do to measure and improve the performance of the business – issues any program or project manager should be thinking about on a daily basis.
1. The role accounting plays a role in downsizing decisions, and how accounting numbers can be deceiving when you are trying to determine which products are profitable and which products are not.

Using a case about a parts subsidiary of a U.S. auto maker, we explore the economics and accounting of downsizing. The subsidiary is losing money, but will eliminating unprofitable product lines restore profitability?

What happens when the accounting system fails to highlight those costs that will be avoided in the downsizing decision? How can accounting numbers deceive in regard to profitability?

2. The impact of cost allocation practices on reported costs and profits. What can happen when an organization decides to adopt a strategy of pursuing a particular type of product, and their accounting practices actually favor a different set of products?

What you should understand about the link between your organization's overall strategy, its accounting practices, and the consequential impact on decision-making.

3. Basic Project Finance: Investing in and Evaluating Projects

In this segment of the program, you learn how companies evaluate investment projects and decide whether or not to undertake them. The discussion focuses on two general topics:

1. The concepts of cost of capital, hurdle rate, and ROI. What should you understand about a company's cost of capital, ROI, and hurdle rate, and what do they mean for project selection and approval? How does risk affect a project's ROI and the firm's hurdle rate?

2. Project evaluation. How do you develop the numbers for a proposal that addresses management's question, “Should we make this investment or not?”

This session is designed to help you develop a better understanding of what creates project value and how financial people think about value creation. You also learn:

- realistic, financially sound arguments that can help you sell a project to senior management
- how to rank order projects when funding is scarce
- how to defend project outcomes and give management a sense of how the project will impact future business performance

Every organization has metrics, and in this session we focus on the kinds of metrics various organizations use internally to evaluate senior management. We also help you to think about your own organization’s metrics, and:

- what incentives these metrics give you, and how your projects are going to be shaped by the internal performance measurement system of your company
- why you must start thinking about the impact your business decisions will have on the organization’s performance measurement system, and, ultimately, the firm’s financial statements
- how financial data is used to evaluate the performance of departments, organizations, and divisions, such as:
  - the different financial elements that are included in the firm’s performance measurement system (e.g., EBITDA, overhead, ROE)
  - how different transactions (risks) are likely to impact overall firm performance and specific performance measures
  - how cost allocations and overhead affect performance measures
- how to forecast the probable impact of various management strategies on firm performance

Team Attendance

It may be particularly beneficial to attend with other members of your project team. Together, you’ll have a unique opportunity to understand about ways you can use accounting strategies to select, evaluate and defend key project choices, and create real value within the organization.

Case: Performance Measurement and Metrics

This case explores how different accounting policies can change the apparent performance of a business unit. In particular, it addresses the issue of accounting for excess capacity in periods when demand for output is low.

A company decides to build a second manufacturing unit, doubling their capacity, even though demand only increases five percent a year. As the manager in charge, you see your evaluated performance go from good to terrible because you have extra costs to bear and no revenue associated with those extra costs.

Eventually, in 10 years, you will be at full capacity, but if you’d waited 10 years to build, you would have given up all sorts of revenues. What are the different accounting techniques you can use to overcome this problem?
Program Faculty

Joseph P. Weber

Joseph P. Weber is a tenured Associate Professor in Economics, Finance, & Accounting at the MIT Sloan School of Management.

He specializes in empirical work on the importance of accounting information in financial markets. One stream of research focuses on how managers choose among accounting methods (i) when communicating corporate financial performance and (ii) when designing and implementing contracts between the firm and its managers and creditors. A second stream of research focuses on the effects of audit quality, disclosure quality, and financial analysts on the functioning of capital markets.

Over the last eight years, he has published over a dozen papers that appeared in the three leading accounting academic journals on these topics (The Accounting Review, the Journal of Accounting Research, and the Journal of Accounting and Economics). When not conducting research, Weber teaches the core financial accounting class to first year MBA students, the Ph.D. seminar in empirical accounting research, and executive education classes on financial accounting at MIT Sloan. In 2007, he won the teacher of the year award at MIT Sloan. Prior to entering academia, Weber worked for Price Waterhouse and AXA Financial.

Scott Keating

Scott Keating is a Senior Lecturer in Economics, Finance, & Accounting at the MIT Sloan School of Management. His research focuses on understanding the internal workings of large and complex organizations.

Keating is specifically interested in the role of internal accounting practices – such as accounting-based performance measurement and compensation programs, transfer pricing policies, costing systems, and cost allocation practices – in regulating organizational activities. He teaches an undergraduate course in financial accounting and a second-year MBA elective in managerial accounting.

Prior to joining MIT Sloan, Keating was on the faculty of the University of Chicago Booth Graduate School of Business and the University of Rochester Simon School of Business. He has also taught at the London Business School.

He has a DBA from Harvard University, an MBA from the Tuck School at Dartmouth College, and an LLB and a BSc from McGill University. He has consulted to and/or taught at numerous companies including Abbott Laboratories, Armstrong World Industries, Brooks Brothers, Deutche Telekom, Procter & Gamble, US Gypsum, and Wal-Mart.