

PREPARATION OF PERFORMANCE REPORTS



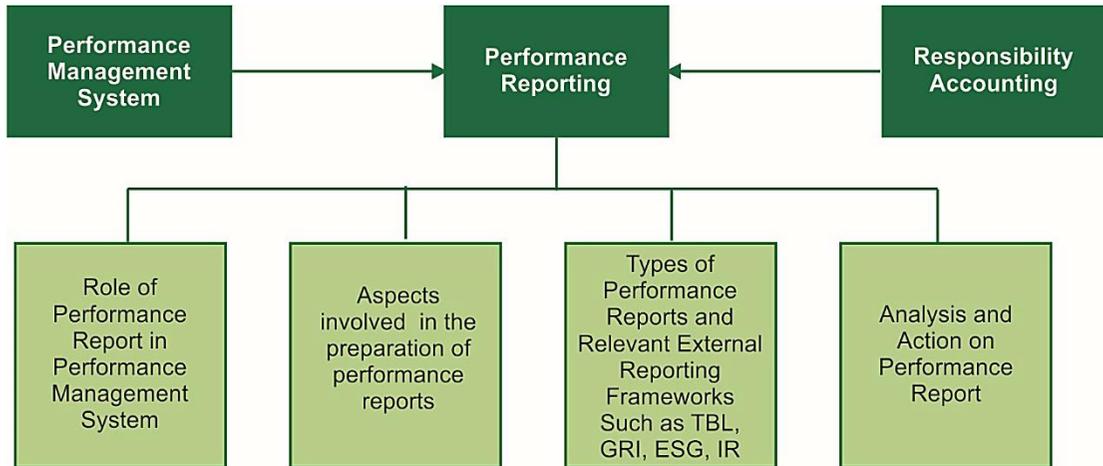
LEARNING OUTCOMES

After studying this chapter, you will be able to:

- EXPLAIN the role of performance reports in the performance management system (performance measurement and evaluation) in the context of responsibility accounting
- EXPLAIN the aspects involved in the preparation of different types of performance reports
- ANALYZE and EVALUATE performance using performance reports



CHAPTER OVERVIEW



A. PERFORMANCE MANAGEMENT SYSTEM

In the previous three chapters of this part, it has been established that performance management shall be considered an essential aspect of management accounting in the case of both for-profit and non-for-profit entities.

Performance management in the case of for-profit entities may be seen as a four-stage solution to take any organisation towards sustainability.

- Firstly, determine the organisational structure and also ensure that the structure is appropriate and best fit.
- Secondly, evaluate the degree of delegation of control and identify the responsibility centres.
- Thirdly, establish the performance measures (both financial and non-financial) and targets for each measure.
- Lastly, review the performance (with help of KPI Dashboard) and take corrective action (if required).

In the case of not-for-profit (public or social sector) organisations, the locus of performance management revolves around value for money (efficiency, effectiveness, and economy).

One should take note that the performance management system, irrespective of size, dimensions, or structure; should be robust, open, and cyclic to serve its purpose.

To ensure performance management system operate efficiently, an information system is required, which must be capable of recording and reporting performance related information.

B. RESPONSIBILITY ACCOUNTING

Responsibility accounting deals with the collection, summarization, and reporting of information where an individual manager is held accountable for certain costs, revenue, or assets of the firm. Hence, Responsibility Accounting lays the foundation as an information sub-system of the Performance Management System to measure and evaluate performance, both in for-profit (private sector entities) and not-for-profit (public or social sector) organisations.

We already acknowledged in Chapter 8 that performance measurement is directly linked to the organisational structure of a business. Responsibility accounting is apt where top management has delegated authority to make decisions, but it can be used in all sorts of organisational structures. The idea behind responsibility accounting is that each manager's performance should be judged by how well he or she manages those items under his or her control.

C. PERFORMANCE REPORTS AND ITS ROLE IN THE PERFORMANCE MANAGEMENT SYSTEM IN THE CONTEXT OF RESPONSIBILITY ACCOUNTING

1. Performance Report

A **performance report** is a document that addresses the outcome of an activity or the work of an individual. The report may compare actual outcomes to a budget or standard, as well as the variance between the two figures. The recipient of a performance report is expected to take action when there is an unfavorable variance.

The process involved is termed **performance reporting**.

To illustrate, a project manager receives a periodic performance report, noting cost and time overruns as per the yardstick (KPI) specified. In the case of a Not-For-Profit or a social entity, best example can be an annual performance report issued by a city municipal council, showing the efficiency, effectiveness, and economic aspects of services provided by each of the various city departments, such as water, sewerage, sanitation, etc.

A key part of a performance report is the baseline from which variances are calculated. If the baseline is not reasonable, then any outcomes derived from it will be invalid.

2. Role of Performance Reports

Responsibility Accounting is implemented by issuing performance reports at frequent intervals that inform responsibility centre managers of the deviations from budgets for which they are accountable and required to take action.

Performance reports are useful for not only comparing budgeted results to actual results but also for showing managers the effects of activity changes and how well these changes are controlled by management.

Note that- *the reports start from the bottom and move upward, with each manager receiving information on the operations of the unit for which he is directly responsible and summary information on the performance of other lower-level managers under their direct or indirect control.*

No matter how much authority and autonomy are given to responsibility managers, performance reports are needed to evaluate the performance of the managers at all operating levels of the organization. At the bottom levels, it helps in determining what corrective measures are required in their segments. At the top management level, these reports keep top managers informed on the performance of all segments.

The responsibility accounting performance report collects all of the responsibility accounting budgets made for each department and summarizes them in one large report.



Do You Know?

Why do entities issue and use performance reports?

- Focus attention on issues and aspects that are causing poor performance (bringing these items to the attention of both managers and employees).
- Quantification and prioritisation of issues – to enable report recipients to take a decision if the flagged item in the report represents significant concerns that warrant immediate attention.
- Foster a communication platform that pushes the recipient as well as the responsible manager to discuss the highlighted issues.

In addition to these, the following can also be included in the list of reasons –

- Benchmarking.
- Resource planning (including monitoring of workers).
- Enhance business performance.
- Smooth flow of communication.
- Preparation of external reports.

3. Aspects Involved in the Preparation of Performance Reports

Despite the fact that system of performance reporting (preparation, circulation and use of the same) can vary from entity to entity, the process of preparation involves certain common aspects that can be seen as steps in sequence –

3.1 Have a clear idea about the need and use-case for the user/ receipt

This is the standard principle that applies to any reporting system universally that understanding the user is essential to choose the information to be included, detailing thereof, etc., ultimately serving the purpose of performance management.

The performance report is mainly written for senior management, but it is also used by people at the other two lower levels of management and by executives as well. Their needs from the performance report are supposed to be considered before drafting the same.

3.2 Establishment of Objectives in light of Organisational Objectives (Vision or Mission)

After identification of the audience, the next big task is to identify the CSFs and KPIs to be reported, for that aim reporting system need to be established in light of objectives and goals of organisation which are constructed or drawn from organisational vision and mission.

 **Note:** This topic has been covered in detail in Chapter 9 of this part of the syllabus.

3.3 Add an Executive Summary

Executive summary gives an overview of details regarding the performance information stated in the report. It is basically a snapshot (synopsis) that contains a brief and concise form of the information that the report will discuss.

3.4 The Real Stuff - Performance Assessment

After synopsis, the actual assessment of performance shall be placed. This section of the report considers each part or activity (reporting segment or responsibility centre) of business by evaluating all the major KPIs and metrics involved in measuring the performance.

Performance assessment usually compares performance (against a benchmark or industry average, i.e., KPIs and metrics of competitors), but apart from transverse (cross-sectional) analysis, longitudinal or time series analysis can also be performed and reported.

The types of information that can be included in performance reports –

| Information | Description |
|---------------------------------|---|
| Financial | Sales, profits, costs, GP%, return on capital employed, etc. |
| Non-Financial Quantitative Data | Percentage of product rejects, volume of sales, number of complaints, etc. |
| Non-Financial Qualitative Data | Changes in reputation, effectiveness, customer satisfaction, staff morale, etc. |

The data provided must be relevant to the purpose of the performance report. Non-financial performance, in particular, is a critical determinant of any enterprise's long-term success. Short-term financial performance in a business can often be improved by reducing quality, innovation, and training. However, a company that pursues these strategies is likely to suffer financially in the long run.

Non-financial information is more important in non-profit organizations, and non-financial performance is frequently an end in itself rather than an enabler of profitability.

Non-financial qualitative information is likely to be as important as quantitative data, but it is more difficult to quantify and present in reports. Technically, qualitative information is referred to as a 'construct,' which is an attribute that cannot be directly measured.

To illustrate, Constructs include things like enthusiasm and empathy. Typically, an effort must be made to convert qualitative information into quantifiable information for communication, assessment, and comparison purposes.

3.5 Layout is Key - Visual Elements and Narrative Commentary can be added

The layout should assist users in understanding the information presented and in quickly identifying the important amounts, trends, results, and explanations. Visual elements (such as tables, charts, graphs, etc.) can significantly improve performance data.

A narrative commentary explaining the information is usually required to draw attention to important issues and explain their significance or causes.

Internal performance reports can take any form that management chooses.

3.6 Details quoted shall be cross-checked

To enhance the reliability and quality of the report, the details quoted in the report shall be cross-checked. Proof-reading can also be performed, especially if the report is to be used as an external report.

4. Types of Performance Reports

As specified earlier, the performance report can be used to compare the actual project to the plan. This comparison can be made for various data points. The most common types of performance reports that can be used are listed below –

| Report | Scope |
|---------------------|--|
| Earned Value Report | Integrates scope, schedule, and cost performance using earned value management techniques. This report is often part of the status report. |
| Forecasting Report | Estimates what is expected to happen, including future performance. This is used for better resource utilization. |
| Progress Report | Report what has been completed or what development have been made since the last progress report. |
| Status Report | Captures the state of the activity at a particular point or project at a particular point in its life cycle. A status report is a kind of snapshot of the current scope, time, cost, and quality of the activity or project. Mostly used in projects, hence termed a project status report |
| Trend Report | Compares the performance against the same period in the previous report. This can be done monthly, quarterly, semi-annually or annually. |
| Variance Report | Charts the difference between the actual vs planned progress of a project. |



D. EXTERNAL REPORTING FRAMEWORKS THAT ARE RELEVANT TO STRATEGIC PERFORMANCE MANAGEMENT

Apart from the traditional financial reporting framework (which has limited scope and relevance due to the reporting of monetary information only), the following sustainability-oriented reporting frameworks are relevant for the practice of strategic performance management –

- Triple Bottom Line
- Global Reporting Initiative
- ESG Reporting
- Integrated Reporting Framework (through value creation)

1. Triple Bottom Line (TBL report)

This overcomes the limitations of traditional accounting systems, which had a restricted view limited to the financial performance of the organisation. TBL expands its scope to include the impact of business decisions on the environment and society as well. The 3Ps draw the organisations' attention to not just the "Profit" motive but also to nurturing the "Planet" and "People" towards a sustainable future.

 **Note:** This topic has been covered in detail in Chapter 9 of this part of the syllabus.

2. Global Reporting Initiative report (GRI report)

This is based on GRI Guidelines issued by an independent institute called GRI, whose mission is to develop and disseminate globally acceptable sustainability reporting guidelines. GRI provides the world's most widely used sustainability reporting standards.

3. ESG Reporting

This is the disclosure of environmental, social, and corporate governance data; its purpose is to shed light on a company's ESG activities while improving investor transparency and inspiring peer organizations.

4. Integrated Report <IR>

Integrated Reporting Framework laid out by the International Integrated Reporting Council (IIRC). It provides the providers of 'capital' with a holistic view of the organisations' value creation process. Since many organisations are adopting integrated reporting, performance is one of the areas covered by integrated reporting. Hence, integrated reporting can be used for the application of responsibility accounting. It is important here to note that an integrated report is a concise communication about how an organization's strategy, governance, performance, and prospects lead to the creation of value over the short, medium, and long term.



Concept Insight

Value Creation

Value creation is not an independent activity within the organization's sole control. Value is created using capital. In integrated reporting, capital is not limited to just financial capital. There are six different categories: *financial, manufactured, human, natural, intellectual, social, and relationship* capitals. The combined effect of these capitals are what results in value creation for the company.

Example

If any engineering department introduced automation (invested in new technology), then the performance report considers its effect and shows the implications, such as reductions in variable cost on account of reductions in man-hours. The budgeted reports would show a low expected level of these variable costs. Upper management could then check the variances between the actual and budgeted costs. If upper-level management sees a manager's efficiency and profitability decrease compared with the budgeted numbers, management can talk with the department manager and try to correct the unfavorable variances.



E. ANALYSE THE PERFORMANCE REPORTS TO TAKE THE REQUIRED ACTION

Once the performance reporting has been established by the organization for its activities or for a specific project, the next step is to analyse the information and take the required corrective (including preventive as well as feed-forward) action. This task typically rests with senior managers or experts who understand business intelligence.

The data that needs to be analysed can be quantitative, such as sales and marketing results, or qualitative, such as customer survey responses. Whatever the type, a structure is required to detail the process, beginning with goal setting and ending with an action plan.

It is critical but equally important that the entity set a time frame for analysis, whether it is a month, quarter, or annual report. This timeframe allows to identify trends.

When reviewing the information from reports, look for anything and everything that pertains to the aim of the analysis currently at hand. Identify and document the trends; pay special attention to aspects that critically align with the aim of the analysis. Then, lastly, summarize the findings and create an action plan to improve performance.



SUMMARY

- ❑ Responsibility Accounting is the collection, summarization, and reporting of financial information where individual managers are held accountable for certain costs, revenue or assets of the firm.
- ❑ The performance report responsibility accounting collects all of the responsibility accounting budgets made for each department and summaries them in one large report.
- ❑ Responsibility Accounting is implemented by issuing performance reports at frequent intervals that inform responsibility centre managers of the deviations from budgets for which they are accountable and required to take action.
- ❑ Benchmarking, Resource planning (including monitoring of worker), Enhance business performance, Smooth flow of communication, and Preparation of external reports are among major reasons or advantages for performance reporting.
- ❑ Despite the system of performance reporting (preparation of performance report, circulation and use of same) can vary from entity to entity, the process of preparing involve certain common aspects that can be seen as steps in sequence.
- ❑ Earned Value Report, Forecasting Report, Progress Report, Status Report, Trend Report, and Variance Report are types of reports that can be used to record and report performance related data for performance evaluation.
- ❑ Apart from traditional financial reporting framework, certain sustainability oriented reporting frameworks such as Triple Bottom Line, Global Reporting Initiative, ESG Reporting, and Integrated Reporting Framework (through value creation) are relevant for practice of strategic performance management.
- ❑ It is critical but equally important that entity should set a time frame for analysis, whether it is a month, quarter, or annual report. This timeframe allows to identify trends.



TEST YOUR KNOWLEDGE - MCQS

MCQ 1

Which one of the following statements about internal performance reporting is true?

Options

- a. Always contain a mixture of financial and non-financial measurements.
- b. Can take any form that management chooses.
- c. Are required by an accounting standard to be based on the 'Balanced Scorecard' system.
- d. Contain the same information as financial accounting statements, but they are produced monthly rather than annually.

Key – b

Reason - Internal performance reports can take any form that management chooses considering the need of organisation, as these are voluntary reports not statutory required.

MCQ 2 – Since performance report also includes reporting on non-financial measures, you are required to identify which of the following statements correct about the non-financial performance measures?

- i. Non-financial measures do not involve the calculation or recording of any numbers.
- ii. The most appropriate non-financial measures vary, depending upon the nature of the organisation.
- iii. Non-financial measures should correspond as far as possible with the aims of the organisation as a whole.
- iv. The use of non-financial performance measures helps to address the deficiencies of measurements such as Return on Investment (ROI).

Options

- a. i, ii, and iii
- b. ii, iii and iv
- c. iii, iv and i
- d. iv, i, and ii

Key – b

Reason – Only statement i is incorrect rest all are correct. Non-financial qualitative information is likely to be as important as quantitative data, but it is more difficult to quantify and present in reports. Technically, qualitative information is referred to as a 'construct,' which is an attribute that cannot be directly measured. **To illustrate**, Constructs include things like enthusiasm and empathy. Typically, an effort must be made to convert qualitative information into quantifiable information for communication, assessment, and comparison purposes. The conversion of construct into variable involves the calculation or recording of any numbers.

