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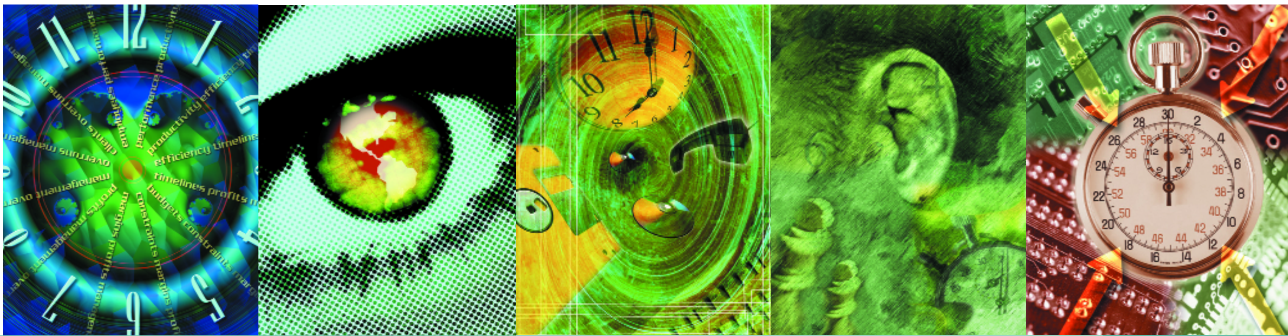

Performance Reporting to Boards:
A Guide to Good Practice

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1 Preface

Many post-Enron discussions about corporate governance have focused almost exclusively on the responsibilities of directors and the structure of boards. This is hardly surprising – after all, a company's survival ultimately depends on the effectiveness of its board's decision-making processes. But boards don't exist in a vacuum. In order to make the right decisions, directors must base them on good-quality, timely information on how their businesses are performing. The quality of performance reporting to boards is therefore one of the key factors affecting companies' competitiveness.

This report sets out principles for the effective reporting of financial and non-financial information to boards. It's meant to guide both directors and those preparing board reports. We hope that finance professionals will find it useful in considering how they engage executives and senior managers.

It's not meant to be prescriptive; the intention is that the summary tables of good practice and the case studies will act as a springboard for new thinking and give you useful ideas for making improvements in your organisation. Ultimately, board structures and decision-making cultures will depend on a company's unique circumstances. Large companies may also operate different levels of boards throughout their businesses. The complexity of large international organisations with many subsidiaries makes the issue of management information and decision-making more complex, and the need for directors of such vast organisations to have early-warning systems is a must.

This guide isn't about the latest management techniques and reporting technologies either. Although many such tools exist (and some are proving useful), recent cases of corporate failure have underlined the importance of performance reporting – an area that many firms assume is simple but find hard to get right. The case of Marconi, for example, raised questions about how timely the board's information was, whether it was of good enough quality to support high-level decision-making and whether it was conveyed in the right manner.

CIMA is concerned with the board reporting practice that's necessary for good market performance and sound corporate governance. The case studies at the end broaden this perspective by revealing two innovative approaches to improving performance reporting. The first case study describes how logistics company DHL changed the focus and structure of its performance reviews with a view to improving decision-making at board level. The result was the appointment of a team of business performance analysts dedicated to supporting the directors. The second case study, from management consultancy Metapraxis, focuses on the implementation of an early-warning support system for directors at Tomkins plc. The approach was designed to help the group's finance teams support their boards with relevant and forward-looking information. ■

2 Who should read this report

This report will be particularly useful for:

- Board members – to reassess the reports they receive to ensure that they are being given the right type of information by which to steer the organisation towards its key objectives. In a business environment dominated by fear of liability, knowing that your decisions are based on the most relevant facts can be reassuring. For individual directors it represents a way of limiting their exposure to any allegations that they are failing to discharge their duties to shareholders. The onus is on them to ensure that they are getting the information they need, rather than passively consuming what they are fed.
- Finance directors and preparers of financial and business performance information – to gain a source of ideas on reporting. The information within their control will be financial and non-financial, and both need to be presented clearly if they are to reflect the performance of a company. Finance professionals must understand how to deliver performance information in the context of decisions that need to be made by the board. This is especially true for large international organisations with many subsidiaries, where the layers of management and the number of boards may obscure the relevant figures and breed a lack of common understanding of what the key performance drivers are.
- Managers – to gain an understanding of the information needs of the board and to see the performance report as a strategic extension of day-to-day information-gathering. The information and decision support that board members receive enables them to discharge their duties in an appropriate fashion. It can also be a good indication of the relationship that exists between the board and the management. ■

3 Introduction

The board of directors in any organisation is responsible for its operational, strategic and financial performance, as well as its conduct.

Boards exercise their responsibilities by clearly setting out the policy guidelines within which they expect the management to operate. They will set out the short- and long-term objectives of the organisation and a system for ensuring that the management acts in accordance with these directions. They will also put procedures in place for measuring progress towards corporate objectives.

There is therefore a clear difference between the main responsibilities of directors and managers. In his recent book, *Corporate Governance and Chairmanship: A Personal View*, Sir Adrian Cadbury distinguishes between direction and management: "It is the job of the board to set the ends – that is to say, to define what the company is in business for – and it is the job of the executive to decide the means by which those ends are best achieved. They must do so, however, within rules of conduct and limits of risk that have been set by the board. The board is ultimately accountable for both the company's purpose and for the means of achieving it. The task, however, for which the board alone is responsible is the determination of corporate ends."

Provision A1.1 of the Combined Code states that the board should have a formal schedule of matters specifically reserved to it for decision-making and that the annual report should include a statement of how the board operates, including a high-level statement of which types of decisions are to be taken by the board and which are to be delegated to management. It is generally accepted that the former should cover:

- business strategy, including operating, financing, dividend and risk management policy;
- the annual operating plan and budget;
- acquisitions and disposals that are material to the business;
- authority levels;
- the broad framework and cost of directors' remuneration (on the advice of the remuneration committee);
- the appointment and removal of the company secretary;
- approval of financial statements. (*The Corporate Governance Handbook*, Gee Publishing, 1996).

Having sound information on which to act is key to this process. Any attempt to formulate business strategy or set tactical plans without it is bound to misfire – the board runs the risk of failing to discharge its responsibilities effectively. This will ultimately result in poor decision-making and, at worst, increased liability for directors.

It is worth remembering that boards require both financial and non-financial information. The pressure for multi-dimensional reporting is likely to increase with the proposed legislative changes such as the mandatory operating and financial review (OFR). This requires directors to give a qualitative, as well as financial, evaluation of performance on a wider range of issues, including policies and performance on environmental, community, social, ethical and reputational matters. Although the detailed content of the OFR itself will not be audited, the process of preparing it and its consistency with the financial figures will be. The OFR means that the disclosure of non-financial information will no longer be an optional extra for large public organisations and very large private companies.

The scope of information flowing through the company to the board, and then from the board to the investors, will have to be broadened. Companies need to ensure that they have systems in place that can generate and collect such data, as well as processes and people capable of analysing and presenting it to the board, and then to the markets, in a meaningful form. ■

4 The principles of financial and business reporting

The board should:

- Set aims, policy constraints and guidelines, objectives and broad strategy, and then confirm these to the executive management team.
- Agree defined performance indicators.
- Ensure that it is receiving all the key information to enable it to probe and question; focus on critical success areas and key performance indicators; and identify appropriate management actions where there are positive or negative variances from projected performance.
- Periodically review the information it receives to ensure that it is getting what it needs and that all board members fully understand it. The board should guard against being inundated with an unnecessary amount of data that provides little or no information and which may prevent it from taking action.
- Ensure that the performance reporting process links objectives, principles and practices to its needs. ■

5 The characteristics of good information

Performance reporting is a means to an end, never an end in itself. The purpose of information is to promote action. The board report is therefore *the* document that pulls together all the relevant information with balance and objectivity.

A good report should contain all the information necessary to facilitate decision-making at board level. It should lead directors to ask the right questions and initiate a chain of actions that will enhance the ability of the enterprise to achieve its short- and long-term aims and create sustainable shareholder value. Finance departments are particularly important in this context, since the information they provide reflects the overall health of a company. Finance directors have a critical role to play in ensuring that the information received by the board is unbiased, even-handed and multi-dimensional.

Having robust systems for collecting, storing and analysing financial and non-financial information is important, but the value of integrity and transparency should not be overlooked. There is always a risk that information could be distorted on its way up to the board. In some companies, finance directors may face pressure from the chief executive to restrict the amount of negative information that's provided to other directors and investors. Working at the heart of shareholder-value-managed companies and the decision-making process, a CFO is in a position to give the board a more prudent view of the state of the business.

Good-quality information should be:

Relevant. Information presented to the board should be sharply focused and reflect the defined objectives and the overall strategy of an organisation. It must not obscure the overall picture with irrelevant detail.

The board should be able to drill down and access further supplementary reports where necessary. The information should be sufficient to allow the exploration of as many alternatives as are necessary for impartial decisions to be taken.

If the board is to exercise its strategic, long-term planning function fully, it needs to focus on more than the current performance indicators. They may say something about historical performance – ie, how it measures up to past objectives – but they can be a poor predictor of the future. The board should therefore have some forward-looking information at its disposal, including trends, projections and forecasts, but these should be based on more than a simple extrapolation of past data.

It's often hard for those who prepare the information to know what level of detail they should go into when compiling board reports. Non-executive directors may not know the ins and outs of the operational side of the business. Executive directors, on the other hand, need to balance the task of running the company with that of setting its strategic direction – what have been called their conformance (past- and present-orientated) and performance (future-orientated) roles. The right balance must be struck between too much and too little detail. As thought leaders and providers of decision information, finance professionals should be making this balance their goal.

Integrated. Organisations are obliged to produce information for a range of internal and external purposes. CIMA thinks that the systems and processes used to provide this information should, as far as possible, be integrated. In other words, the data collected internally should be managed in a way that satisfies both internal and external reporting needs. We believe that the information needs of directors are broadly similar to those of investors, except in the level of detail required.

Some of the information that boards require – eg, benchmarking competitor data – cannot be generated internally but will have to be collected from external sources. The same principle of conciseness should apply. The overall objective should be to have information that maps the business entirely.

In perspective. Information should be presented in relevant time context. Estimates of the projected time situation should always be plotted over time. This acts as an internal benchmark for the performance of each aspect of the information. Where, for example, historical, current and projected scenarios are presented, operational problems are brought to light wherever the variances are significant. This applies as much to the monitoring of contracts and projects as it does to the profit and loss account and balance sheet.

Timely. It's better that the board receives information that's imperfect (but within acceptable tolerances of precision) in good time than completely accurate information too late.

Marconi is often cited as an example of a company that failed partly because its board didn't receive timely information. In other words, it wasn't simply a case of incompetence or flawed risk assessment, as is often stated. The simple truth is that the company's directors may not have had the chance to act, because they didn't find out what was going on until it was too late.

Information should, as far as possible, be available in parallel with the activities to which it relates. The report should be available promptly enough to plan from it and/or take action to consolidate gains and recover shortfalls.

Monthly board reports should contain performance information relating to key operational issues as defined by the board: the critical success factors (CSFs) and key performance indicators (KPIs). Quarterly board reports should contain a broader coverage of organisational activities and should also address qualitative areas of the business.

It's important that only the key pieces of information are presented monthly to enable a succinct and useful report to be

Quality, not quantity

The climate of fear and uncertainty that the Enron scandal created may mean that some managers are tempted to increase the amount of information they provide to the board for fear of omitting something relevant. But boards should not be burdened with an excessive amount of operational detail. Micro-management won't ultimately lead to improved business performance. If anything, it will weaken the organisation's strategic focus. Something is wrong in a company where directors spend much of their time sifting through huge management reports. The question to ask is how much knowledge has been lost in the information?

The information provided should always be tailored to the board's needs and relevant to the current strategy and business model. It's up to the management to distil this day-to-day information and focus the directors' minds on potential problems and discrepancies. Of course, there needs to be a great deal of trust between the board and the management so that the directors aren't in doubt that they're being told what they need to be told.

Finance professionals need to do more than simply put the right numbers on the boardroom table. If they are to add value, they must also act as strategic advisers, explaining what's behind the information and pointing out possible solutions to any problems. In the words of Sir Adrian Cadbury, they must give their own "best judgment on the company's financial position". In order to do this, accountants in business need to have a real understanding of the business model and the value-adding processes that underpin it.

Where they do have this knowledge and understanding, accountants in business are also in a position to challenge other parts of the organisation to determine what kind of information is required for better decision-making. (See the section on the CIMA strategic enterprise initiative on page 12 for a view on how the finance function and an SEM approach can help an organisation to improve its decision-making.) But it is worth remembering that, although accountants need to add value and enhance their role as strategic advisers, they mustn't lose sight of their basic financial control responsibilities.

In some companies, internal reporting can be completely divorced from the decisions that need to be taken and the strategy it's meant to be supporting. It has simply evolved over time and contains worthless information. Not only can this result in information overload; it also may mean that directors are not making decisions based on facts. Reliance on intuition and gut feeling has always been a crucial element of decision-making, but it's best to have all the facts available and an agreement about the key performance drivers.

How the information is summarised and salient points extracted depends on the skills of the management and the ability of the board to define what it needs. Responsibility for good-quality and timely reporting is therefore a joint one. Directors must play a part in determining the right measures of performance and ensuring that they are effectively monitored. They can also add value by being proactive – for example, by asking for clarification, additional information and so on.

At the heart of the whole process is a culture of trust and openness. Directors – especially non-executive directors who will lack the detailed knowledge of the business – must be able to trust that executive directors and managers will tell them all they need to know. If this is not the case, the system is built on shaky foundations and only good fortune will prevent it from failing.

produced. But recent research sponsored by KPMG has highlighted the danger of reporting KPIs by exception only. Many non-executive directors in its survey blamed this for their limited understanding of business processes, value creation and customer satisfaction – crucial strategic areas for any company.

Reliable. Information should be of good enough quality for the board to be confident in it. This will depend on its source, integrity and comprehensiveness.

The pack supplied by the management before the board meeting will be the key source of information for board members – especially non-executive directors. But there are other channels available, including business publications, formal and informal contacts with staff below board level and so on. Last, but not least, the extra information and analysis delivered orally by the CEO or other executives with different areas of responsibility will probably be the most useful in terms of decision-making.

Comparable. The board report is the performance report for the organisation and it covers both financial and non-financial aspects of performance. For financial performance, comparing what happens (actual) with what should have happened (budget/plan/rolling forecast), or in some cases what did happen previously (last month/year), will be valuable. Presenting a forecast year-end position will focus minds on the effectiveness of an organisation, rather than just its economy and efficiency. Comparison with budget should be one of the key management tools, but the emphasis should be on the future, which can be influenced, rather than the past, which cannot.

Clear. Reports should always be written clearly and simply. Everyday language should be used wherever possible and jargon or acronyms should be avoided. Used judiciously, graphs and charts can be an effective communication medium for key indicators. They also enable trends to be identified more easily.

Apart from the information they receive at the start of their tenure, directors would normally expect to see:

- monthly consolidated profit and loss accounts, balance sheets and cash flow reported against budget;
- a further breakdown of results by strategic business unit, where they are of a size material to the overall performance of the company;
- a quarterly update of forecast results for the trading year;
- specific papers on new investment projects above an agreed size;
- updates, as appropriate, on major expenditure, such as acquisitions or large building projects;
- a six-monthly review of progress on the implementation of the strategic plan.

The value of informal information should not be underestimated, as *Good Governance*, a CIMA-commissioned research report states: "Genuine board member access to an organisation's staff, premises, clients and operations can sometimes reveal far more than the board papers. It is also qualitative as well as quantitative – copying for the board all of the documents and figures that managers use in their work does not necessarily mean that the board is well informed. Its members may be swamped, or the board-level implications may be unclear, thereby preventing the development of a well-formed overview of the key trends and issues affecting the organisation."

Again, it's worth repeating that there's a danger that the amount of informal information provided can become excessive, leading the board to focus too much on operational matters. ■

Playing the system

Even when a company has a well-structured internal reporting system, the targets and objectives it relates to must be realistic, achievable and aligned with the culture of the organisation. If this is not the case and the system is not 'owned' by staff, there remains a temptation to try to get around its constraints.

The recent case of a FTSE 100 company with a reputation for excellent internal reporting illustrates the danger. As it issued another production warning, analysts speculated that the reason for the company's sudden panic was that subordinates had failed to reveal the extent of its troubles to senior managers. The *FT* speculated that the cause of the problem may have been that the performance targets were so stretched that staff felt under pressure not to reveal the real results to their superiors.

6 Transparency

Internal reporting has implications that go beyond board level. If directors are committed to telling investors about the key value drivers of business performance – which will enable them to value the company more accurately – it follows that the information used to manage the company should not be radically different from that which is reported externally.

The problem is that many firms spend more time trying to get the right figure to satisfy market expectations. The struggle to meet quarterly targets can cause them to lose focus on long-term value generation in favour of making short-term decisions that give them the right numbers to report. These ultimately destroy shareholder value. The failures of Enron and WorldCom are only the extreme examples of this practice.

CIMA has been calling for greater transparency in reporting as the only way to restore the trust in capital markets that was lost after the recent accounting scandals. Investors are still hypersensitive to the possibility of inflated earnings, so transparency has become a matter of survival rather than choice. The investment community does not want to see a sanitised version of the information used to run the business.

In essence, greater transparency means improved disclosure. By this we don't mean that companies should start reporting more; it's simply that what they report should be the information the market needs. If enough companies start reporting this way, the fear of being held hostage to fortune will diminish. But it's not only companies that have a responsibility to ensure that the highest-quality information is provided to capital markets. The Fédération des Experts Comptables Européens (FEE) has sketched out a network of participants who must contribute to this goal:

- Preparation of true and fair financial information by an effective company accounting function.

What makes financial information useful

According to the Institute of Chartered Accountants in England and Wales in its draft guidance for UK directors (July 2002), useful financial information has the following characteristics:

Material.
- It comprises only items of information whose size or nature mean that their misstatement or omission might reasonably be expected to influence the economic decisions of investors.

Relevant.
- It has the ability to influence economic decisions of investors.
- It is provided in time to influence economic decisions of investors.
- It has predictive value or, by helping to confirm or correct past evaluations or assessments, it has confirmatory value.

Reliable.
- It can be depended upon by investors as a faithful representation of what it purports to represent – or what it could reasonably be expected to represent.
- It is neutral, because it is free from deliberate or systematic bias intended to influence a decision or judgment to achieve a predetermined result.
- It is free from material error.
- It is complete within the bounds of what is material.
- It is prudent in that a degree of caution is applied in making judgments under conditions of uncertainty.

Comparable.
- It can be compared with similar information for other periods and other entities so that similarities and differences can be discerned and evaluated.
- It reflects consistency of preparation and presentation, providing that this is not an impediment to improvements in practice.
- It is supported by the disclosure of the accounting policies used in its preparation.

Understandable.
- It involves the characterisation, aggregation and classification of transactions and other events in accordance with their substance and their presentation in ways that enable the significance of information to be understood by users.
- It presumes that users have a reasonable knowledge of business and economic activities and accounting, and have a willingness to study information with reasonable diligence.

According to management consultancy Metapraxis, board members should consider the following questions about the information they are receiving:

- **Accuracy**. Can I trust the data?
- **Relevance**. Does it cover the critical issues?
- **Timeliness**. Is it sufficiently up to date?
- **Clarity**. Is it presented in such a way that I can digest it quickly?
- **Risk assessment**. Is the information purely historic or does it assess future risks?
- **Depth**. Do I receive only summaries or can I access individual subsidiaries?
- **Provision**. Can I access the data via a secure internet connection?

- Informed review by directors, audit committees or supervisory boards.
- Internal audit.
- Proper approval procedures for financial information by the body responsible within the company.
- External audit and external review subject to quality-assurance systems that inspire public confidence.
- Effective enforcement bodies.
- Stock exchanges with supportive listing requirements.
- Sponsors, advisers and investment bankers committed to high-quality financial reporting, particularly in respect of complex transactions.
- Investors, analysts, rating agencies and the financial press, all of whom should have clear ethical obligations to raise issues of dubious financial reporting.

In their book *Building Public Trust*, Samuel DiPiazza and Robert Eccles draw up a similar corporate reporting supply chain. They assert: "If management is not transparent with its own board, how can it practice external transparency? If management is not willing to be held accountable by the board, how can it have the legitimacy to hold accountable others in the company?"*

In the KPMG survey, non-executive directors (Neds) were asked whether they had sufficient knowledge in a number of specified areas. Where the answer was negative, one of the main reasons quoted was the lack of appropriate reporting by management. Similarly, in a survey of Neds conducted by Mori for the Higgs review, two of the top three items cited as barriers to greater effectiveness were "executive directors holding back information" and "a lack of knowledge/understanding of the company".

The case of ABB illustrates this point. Until recently, the Swiss engineering group was one of Europe's most admired companies, gaining plaudits from eminent publications such as *Harvard Business Review*, which praised its model of "individualised corporation".

Jürgen Dormann, ABB's chief executive, admitted that many managers had been exaggerating the performance of their divisions to hide problems. This is partly why the company is now struggling to retain investors' confidence while trying to cut its debt burden.

One of the attributes of ABB's model of management was the idea that dependence on information systems should be replaced by developing good personal communications with those who have access to vital intelligence. The imperative was to "lighten the burden of control systems by developing personal values and interpersonal relationships that encourage self-monitoring" (*Harvard Business Review*, May/June 1995). It is now clear that such endeavours have largely failed.

Percy Barnevik, one of ABB's previous chief executives, implemented an accounting and communication system that was meant to generate company reports from a single database. The rationalisation of information systems for internal and external reporting is undoubtedly helpful, because it prevents managers from debating the accuracy and relevance of data. But an underlying culture in which managers embellish their results can undermine the whole model.

A culture of openness may be a prerequisite for effective internal reporting, but it can't exist without a sufficient level of control. In a recent CIMA executive briefing on business transparency (www.cimaglobal.com/downloads/enron.pdf), David Phillips, head of PwC's ValueReporting™ initiative in Europe, predicted that we would soon be in a world where a single database would be used both to run the business and to communicate with stakeholders. The only real external reporting issue would be where to draw the line of transparency across the information, since some of it would inevitably be commercially sensitive.

As CIMA sees it, transparency – as an overarching concept guiding the reporting process in a company – should become the cornerstone of good corporate governance. As long ago as 1990, we argued that there should be better disclosure of information (while preserving commercially sensitive data, if necessary). A CIMA publication entitled *Corporate Reporting: The Management Interface* called for companies to make boardroom information publicly available.

It said: "One function of financial reporting is for management to explain its progress towards meeting its strategic objectives. It follows that there must be benefit in publicly reporting the sort of information that management uses internally."

A more recent CIMA research report, *External Reporting and Management Decisions*, examined the influence of external reporting on management accounting in companies. It concluded that the requirements of external reporting didn't have a major impact on internal decision-making in the firms it examined. It said that the traditional distinction between management and financial accounting didn't provide a useful framework for understanding the impact of external reporting on internal reporting. Instead, it was better to think of it as a single generic process comprising several layers of information-gathering, reporting and use. As far as most managers in the research were concerned, there was only one mainstream accounting process in a company.

In the companies surveyed there was a clear overlap between internal and external reporting – for example, monthly management accounts were often in the same format and structure as the external ones. The researchers found that the common thread was in fact the framework of accountability and the assessment of financial performance.

This research clearly shows that day-to-day management decision-making is based on much more than financial information alone. Although many firms tend to report only their financial information, in reality it comprises only one part of the total information system that's available to managers – and that investors are interested in. In fact, the finance function already serves as a repository for a lot of non-financial information in many companies. But there needs to be a systematic approach to what is collected and how it is reported upwards.

This convergence of internal and external reporting clearly has implications for both management and financial accountants, since it erodes some of the difference between the two. It doesn't mean that their roles will become redundant, but it does mean that they will need to understand better how each affects the other and how they can be brought into line to achieve better decision-making and a simplified system of external reporting. For management accountants in particular, their commercial awareness and ability to evaluate business performance is the basis of ensuring such convergence. ■

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7 Key performance indicators

Performance information should be focused, with key elements highlighted. Where appropriate, all problems, explanations and solutions suggested by those who prepare the reports should be laid out in front of the board. The directors can then assess, advise and initiate appropriate courses of action for the management to take.

The board and management should agree the high-level KPIs to be covered in the report. These should:

- draw together and integrate management information;
- reflect the critical success factors of the organisation and provide a high-level aggregate overview;
- be part of a normal business routine;
- be comprehensive;
- provide a reliable and easy-to-use base through which to provide information that the board finds meaningful;
- be appropriate to a challenging management environment and be reviewed regularly.

Management should be able to drill down from high-level indicators to examine the underlying cause of a problem and identify appropriate action. Subordinate details should always be summarised. (See the CIMA technical briefing entitled *Latest Trends in Corporate Performance Measurement* – visit www.cimaglobal.com/downloads/tech_brief_perf_man_160702.pdf to download a copy.) ■

8 Information systems

Management should set up systems to process data into information on the performance of specific areas of the organisation. A good information system should:

- be defined by the company's operating profile, not the other way round.
- distinguish between the critical success factors and those that are merely desirable;
- have an architecture that's flexible enough to survive technological and business changes over time;
- be scalable, offering key information down to detailed analysis;
- be thoroughly integrated with the board's reporting process.

The integration of information for internal and external reporting means that the quality of data generated, collected and analysed internally becomes critical for the successful running of a company. This may sound obvious, but in many firms this information simply isn't available or there is a lack of understanding about what the relevant numbers are. This hampers decision-making, because too much time is spent on reconciling figures or getting information out of different systems. For example, many companies wouldn't know which of their customers are delivering the bulk of their profits or why, or which parts of the business are creating the most shareholder value.

In a survey last year by the Economist Intelligence Unit, technological constraints that made it hard to get an integrated picture of the financial accounts were among the top eight most serious barriers to the implementation of proper corporate governance policies in companies. More than a fifth of respondents, including senior executives and leading corporate and regulatory figures worldwide, cited it as the highest or second-highest barrier. Getting the right information and getting it on time affects both the business operations and strategic decision-making of many companies. ■

9 The CIMA SEM initiative

The CIMA strategic enterprise management initiative (SEM) is about treating decision-making as a distinguishing competence. Although a separate executive report on CIMA SEM and improving decision-making in your organisation is now available from the institute's website (www.cimaglobal.com/sem), it's not possible to discuss better performance reporting without mentioning the initiative in this guide.

CIMA SEM aims to enable management accountants to add value constantly as part of the management team by integrating advanced accounting techniques and their enabling technologies into the business. At the CIMA SEM round-table, a selection of companies discussed their approaches to getting the right information and analysis to the right people at the right time. In formulating and delivering strategic objectives and improving data analysis, the leading companies had, in effect, decentralised their management accounting function. This modified role should involve selling ideas and options to both strategic and operational decision-makers.

The report considers the progress of SEM in organisations and why there is often a difference between the rhetoric of software vendors and the reality. For many companies the ERP or SEM technology has not necessarily led to improved decision making and increased transparency.

The SEM debate is much wider than just leveraging the benefits of ERP systems. CIMA is focused on enhancing the role of the finance function and management accounting to add value by taking the value creation perspective and properly integrating advanced management accounting techniques such as shareholder value management, activity-based management and balanced scorecard ■

10 Applying the principles

Figure 1, below, highlights examples of good and bad practice based on the characteristics set out in part 5, focusing on the financial section of the performance report.

It should be remembered that management will provide a lot of other information to the board on an ad hoc basis in addition to the main board pack. The board pack, in that sense, is about the organisation's ongoing performance rather than exceptional events. In order for the board to give appropriate weight to the most important issues of policy and strategic direction, key exceptions and variances must be highlighted. The action plans prepared by management must be clearly stated.

Figure 2, opposite, highlights good and bad practice for key elements of the report. ■

Figure 1 The financial section of the performance report

Principle	Good practice	Poor practice
Relevant	Focused financial report of three to six pages in length. A good report will summarise the issues and highlight the overall position, making use of graphs and charts to replace lengthy tabular information where appropriate.	Detailed analysis of income and expenditure and variances for all directorates in 32-page report. Limited narrative. No corrective action identified.
Integrated	Activity data linked to financial performance. Variances calculated and explained. The report should integrate non-financial and financial reporting.	No activity data presented in the financial report. No balance between qualitative factors and quantitative ones.
In perspective	Abbreviated P&L account shows period and cumulative positions with highlighted variances against budget. Major variances adequately explained. Trend analysis included. Full-year projections updated.	Massively detailed P&L account. Insufficient detail to support issues identified in the narrative report.
Timely	Report available within five working days of period end.	Information presented 28 days after period end.
Reliable	Every key issue identified with sufficient explanation.	No key issues identified, or no explanation offered.
Comparable	Consistent style across reports. Performance indicators used to illustrate trends in liquidity, asset utilisation, etc. Comparison with budget/previous year.	Inconsistent format and style of report. No use of performance indicators.
Clear	Appropriate use of graphs, colour-coding and clear chapter headings.	Copious financial tables at the beginning of the report. No title or contents pages. Information presented in complex spreadsheets.

11 Performance reporting – a checklist

Figure 2 Key elements of the performance report

Element	Good practice	Poor practice
Executive summary	All key issues identified in an introductory executive summary with a synopsis of performance provided by key indicators. Supporting documentation and appendices clearly referenced.	No simple overview. Information is there, but in a confusing order with no cross-referencing. Typically excessive use of data or unrefined information.
Action plan	Corrective action specified with contingencies and sensitivity analysis showing best- and worst-case scenarios.	No action plan.
Profit and loss	P&L account showing period and cumulative positions with highlighted variances against budget. Major variances highlighted and adequately explained. Trend analysis shown graphically. Full-year projections updated.	Summarised cumulative income and expenditure account. Insufficient detail to support issues identified in the narrative report.
Projected outturn	Projected outturns recalculated on the basis of actual performance and action plans.	No projected outturn plan.
Cash flow	Profiled cash flow summarising actual and projected receipts, payments and balances on a regular basis to year end.	No cash flow information, or only history.
Capital programme	Analysis of progress of major capital schemes showing percentage completion, current and projected expenditure, completion cost and timescale.	No data provided, or only that on under/overspend.
Balance sheet	Indication of working capital position presented in tabular form or using performance indicators – eg, debtor and creditor days.	No working capital information.

- A monthly performance report should be between 10 and 20 pages in length.
- Board members must have enough time to digest it before the meeting.
- Performance reports should:
  – be readily understandable for all members of the board;
  – convey key strategic and operational information clearly and concisely;
  – give an accurate picture of events;
  – present a view of the future, with projections and scenarios for next month, year or longer, as appropriate;
  – prompt a discussion of the options;
  – focus on critical success factors.
- Style should be consistent. This applies to the overall structure of the report and page layout, as well as to the comparators used for KPIs.
- The report should be easy to assimilate, containing graphs, charts, colour-coding, clear headings and selective highlighting; supplementing written reports with presentations; and using external benchmarks and commentary.
- Supplementary information should be annexed only if considered vital to the board's understanding of the report.
- Overall, the report should allow the board to discharge its responsibilities to investors, suppliers, customers, employees and other stakeholders.
- Information should be presented as often as is useful. Some facts are likely to be acceptable quarterly, half-yearly or even annually, but it's up to the board and management to decide on the frequency.
- The report should present the salient strategic and operational information clearly and concisely. It's not the board's responsibility to review raw data. This should be filtered and distilled by management into information to aid the board in its decision-making. The role of the FD and the finance department as a whole is crucial in ensuring integrity, transparency and impartiality. ■

12 Case study 1: extracting value from data – supporting the board at DHL UK

With a 34 per cent share of the global international express market, DHL is one of the world's most successful courier companies, *write Andy Neely and Yasar Jarrar*. It employs 64,000 people worldwide, serving more than one million customers in 228 countries daily.

The volume and variety of transactions at DHL meant that its UK executive team could easily get engrossed in detailed reviews of the division's operational performance at their monthly meetings and risk overlooking strategic issues. It recognised this issue and started asking whether the focus of the reviews was appropriate. In 1999 DHL UK designed and built its performance measurement system according to the Performance Prism framework (see "The Performance Prism perspective", *Journal of Cost Management*, Vol 15, No 1, 2001).

Building and implementing the Performance Prism

To start the design process, the executives participated in workshops where they explored their understanding of the firm's strategy by addressing the five questions embodied in the Performance Prism:

- Stakeholder satisfaction. Who are the key stakeholders and what do they want and need?
- Strategies. Which strategies must we put in place to satisfy the wants and needs of these key stakeholders?
- Processes. Which key processes do we need in order to effect these strategies?
- Capabilities. Which capabilities do we need in order to effect these processes?
- Stakeholder contribution. What kind of contribution do we require from our stakeholders if we are to maintain and develop these capabilities?

Each of these resulted in a "success map" for the specific stakeholder. Having identified the links between these stakeholders, the maps were integrated into one success map for the business.

The next step was to identify what to measure to monitor how these strategies were being implemented. The trick was to encourage the executives to consider the questions they wanted to be able to answer in the light of what was on the success map. Fundamentally, they were being asked: what do you need to know to decide whether the business is moving in the right direction or not? This could be addressed simply by asking what performance measures are needed, but the problem is that measures are only a source of data. As an executive, you don't necessarily want to know the minutiae of such operations; you want answers to questions. The measures are merely a means of accessing data that allows you to answer questions.

The next workshops encouraged the executives to consider the questions they would like to be able to answer at the quarterly performance reviews (QPRs), given the structure of the success map. Once the right questions were identified, it became relatively simple to work out what should be measured. The final workshops focused on what data was needed, and hence which measures were required, to answer the questions they identified. These sessions also involved DHL's performance analysts. The measures design template (see *Measuring Business Performance*, The Economist Books, 1998), was used, as were the 10 "tests of a good measure". The result was a set of measures that mapped on to the questions that the executives had identified (see figure 3, below, for the treatment of a sample question).

DHL UK was fortunate in that it already had much of the required data-capture infrastructure, so there was little need to develop new reporting capabilities. But it did invest a significant amount in education and process facilitation, which turned out to be fundamental.

The next step was to restructure the QPR agenda so that the discussions at the review would reflect the key questions that the executive team had decided they should be addressing. After a year of operation, the QPR agenda evolved and was structured as shown in the sample subset in figure 4, opposite.

Developing the business analyst community

The second major investment that DHL UK made to redesign its performance measurement system was to enhance the skills of the business performance analysts. The firm had deliberately adopted a structure where each member

Figure 3 Subset of questions and measures – regular DHL customers

Question	Measure	Data source	Target	Responsible for providing info
What are our customers doing?	Customer satisfaction	'Smart' research (annually)	Customers satisfied or very satisfied: >88%	Customers, annually
	Number of active accounts	Business unit revenue report	Accounts shipping versus previous year: +4%	Area analyst
	SPD of active accounts	Business unit revenue report	Volumes in shipments versus previous year: +4%	Area analyst
	BSI	Loyalty data	>50%	Area analyst

Figure 4 Sample subset of quarterly performance review agenda

Day one, 9am	**Setting the scene – top-line NR results and forecasts** GCC NR and cost – will we deliver NR target for the year?	**Financial analysis**
9.30am	**Customers** How are our customers feeling and what are they doing? What are our competitors doing? Are we positioned well in the market? Is our revenue quality strategy working? Is our revenue volume strategy working? Is the customer relationship management strategy working? Do we have the processes to support our strategies for CRM? Do we have the money to sustain market leadership? Do we have the human resources to drive differentiation? Do we have the right product offering? Do we have the information to manage these processes?	**Commercial overview**
10am	*Questions on commercial overview*	

of the senior team – in effect, the UK board – had one or more performance analyst reporting to him or her. The role of these analysts was to brief the board member before the QPR on the issues that they felt needed to be raised and to prepare accompanying documentation.

Clearly, if the structure of the QPRs was to be modified in line with the Performance Prism framework, there was also a need to develop a way of enabling analysts to move from working with data to handling information and turning it into value-adding knowledge. To facilitate this process, the board, in co-operation with Cranfield School of Management's Centre for Business Performance, decided to set up a cross-functional analyst community. Its structure would be beneficial in two key aspects. First, all the analysts would have the same skills, which would eradicate any inconsistencies in presentation. Second, the structure would allow the analysts to meet and discuss their analysis within the overall context of the business, taking them out of their functional silos.

The community was developed and managed through various initiatives. The main one was the quarterly business analyst workshop, which was a place to:

- Share best practice in terms of business analyst skills. This included a presentation by one of the analysts on the tools and thinking processes used in his team to conduct an analysis.
- Share information on DHL issues as a whole. Not only did this provide a forum for analysts to share ideas; it also gave them a chance to share their respective analyses before the board meeting and often allowed cross-functional issues to be identified.
- Develop further skills by inviting external speakers to present good-practice cases from other firms and/or disciplines. Speakers in 2001 included a detective, a journalist and business analysts from other industries.

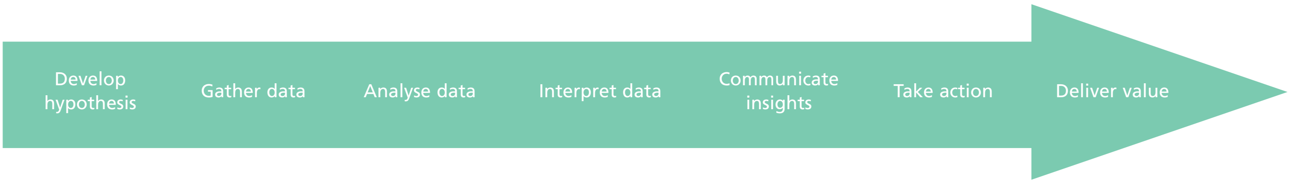
One training programme, which was attended by everyone in DHL's analyst community, emphasised the key analogy of the detective. When detectives are investigating a crime they don't rely on a single piece of data. Instead they gather all of the available evidence and try to piece together the sequence of events. So it should be with performance analysis. When DHL's analysts are constructing a case they should use all of the available data to answer a specific question. Only then will they enable the board to have the right level of debate.

The course covered techniques for extracting value from data within the framework of the performance planning value chain (see figure 5, next page). This offered a method of transforming data – often disorganised in its original form – into high-quality information. It also provided a way to bring together a combination of skills for analysing and interpreting complex information from a variety of sources and the ability to present technical information to non-specialists in an insightful way.

The performance planning value chain framework covers various steps for extracting value from data, including:

- Develop a hypothesis – which questions need answering? This is a crucial step before data collection, requiring the analyst to identify the issues that the analysis will try to unravel. It is about finding the performance gaps that need investigation and about the preliminary areas of focus in terms of the potential problems and possible solutions. Tools used in this process include success maps, process maps and gap analysis.
- Gather data – what data do we need to collect? Do we collect it already? How can we gather it more effectively? Although most companies collect tons of data, few of them trust it, but the tools used in this process ensure that they follow a structured approach. These include sampling plans and data collection plans.
- Data analysis – what is the data telling us? At this point the analysts would start transforming data to information by using tools for quantitative and qualitative analysis. They include, among others, the basic seven tools of quality management.
- Interpretation – what insights can we extract from the data? How will the

Figure 5 The performance planning value chain



message differ by changing the angle from which we look at the data? It's important to separate this step from analysis. Once the charts and graphs have been completed in the previous step, the question is: what does this mean for the business? It's here that thinking as a detective becomes crucial. Tools include information visualisation and benchmarking.

- Communicate insights – how can we best deliver the conclusion we have reached? Valuable insights could be lost if the message is not delivered in the right way, so it's prudent that insights are put in a suitable delivery channel for the audience. Tools here include presentation skills and attention management techniques.
- Take action – how do we act on that data? How do we prioritise our actions? This is where all the work done so far can be transferred into actions to deliver value. Tools here include decision-making and prioritisation techniques, and project management and feedback systems.

The lessons learnt

The improvements have not ended with the Performance Prism and the new QPR structure. Instead, the measurement system has kept developing and will continue to do so. DHL has learnt the following key lessons from the process:

- The role of the board. This has changed significantly now that the performance analysts play a far greater role in the QPRs than before. Instead of preparing material for board members to present, they are expected to deliver their own analysis and, in effect, be cross-examined by the board on two issues: the quality of the analysis and the implications for the business (and the actions required). Involving the analysts more fully has been a crucial development, because it has allowed executives to act as a board, rather than as individuals representing their functions. In the days when the director responsible for compliance delivered the presentation on "how well are we meeting regulations?", he naturally tried to present data that showed his function in a good light. The compliance director is now simply another member of the board. Everyone plays a role in ensuring that the business meets the regulator's requirements, so it's essential that the board grasps the situation and jointly decides what the business needs to do next.
- Focus on action, not measurement. DHL UK has devoted significant effort in shifting the focus of performance reviews to closing the performance gap, rather than justifying the firm's current position. Far too often in organisations the debate on performance data centres on justifying why the business is where it is. Why the business is where it is doesn't matter. What matters is what the business needs to do to get to where it wants to be.
- Prioritising actions. Board members are now more explicit about which of the potential actions they have identified will work best. They achieve this in two ways. First, they evaluate the impact of the proposed action on the customer through their "how does it affect the customer" programme. This requires them to consider the impact of each specific action they are proposing on DHL's customers. Second, they prioritise actions based on importance and required focus using a two-by-two matrix.
- The role of the performance analysts. Various lessons were learnt from the analyst community, which can be summarised as follows:
  – The need for cross-functional analysis. The focus should be on the organisation as a whole, not on functional silos.
  – The need for facilitation to achieve effective board meetings.
  – The need to focus on information not data. Boards must avoid micro discussions and instead focus on their duties as "ship captains".
  – The benefits of creating a centre of excellence such as the business analyst community. The better equipped the analysts are, the more insights they can provide and the more value they can extract from the data. ■

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13 Case study 2: Metapraxis – an early-warning support system for directors at Tomkins plc

Tomkins plc, a world-class global engineering group, was founded in 1925 as the FH Tomkins Buckle Company, a maker of buckles and fasteners, *writes Dominic Powell*. The company remained focused on this specialist market until 1983, by which time it was making an annual profit of £1.6 million on sales of £17 million. It was not until the mid-1980s, following a change of management, that it began to develop into the global engineering group it is today, with an annual operating profit of £266 million on sales of £3.4 billion.

This tremendous growth was fuelled largely by several acquisitions from 1984 onwards, broadening both its product offering and its geographical spread. Companies that were acquired included Ferraris Piston Service, Philips Industries Inc, Rank Hovis McDougall, Gates Corporation and ACD Tridon. Many of the acquisitions that were made in the 1980s and early 1990s were based on the technique of targeting poorly performing businesses in unglamorous industries, selling off underperforming assets and tightly managing the firms through to health.

Subsequent restructuring focused on the group's engineering strengths, leading to the formation of three core engineering businesses: Air Systems Components, Engineered & Construction Products and Industrial & Automotive. The culture of the company has developed in line with this restructuring over the past couple of years. Divisional managers have been encouraged to widen their focus from the tight financial management of the business units to an in-depth, ongoing assessment of how these units ought to compete in their respective marketplaces.

This has been underpinned by the development of management reporting systems and processes. Specifically, the management reports and processes that have been implemented have moved the emphasis away from the production of aggregated transaction data towards an ongoing performance analysis.

Phase 1 – a need for change

By 1999 Tomkins had a bottom-up performance reporting system whereby each of its 50 to 60 business units and divisions submitted their results in a fixed format – including a balance sheet summary, a cash flow summary, capital expenditure summary and an income statement – every month. The reports were in addition to the yearly financial plans. These comprised the same analyses as well as a number of others – eg, "cash added value" statements, which helped to ascertain whether the cash return in the business unit exceeded the cost of capital over the period covered by the plan.

Information was submitted electronically to Tomkins Corporate Centre's centralised management database. Monthly consolidated reports were then generated and sent through to the company's executive management. In addition, business-unit performance reports were returned to divisional management to be reviewed.

These statements provided a roadmap for business-unit, divisional and corporate managers to formulate and agree forecasts, as well as to calculate performance against targets. The main benefit of the system within such a large conglomerate was that the board received a consolidated set of information about the performance of the three key divisions and the constituent business units.

The main drawbacks of the system were as follows:

- The sheer volume of data from around 50 to 60 operating companies obscured the key business messages within that data.
- The complexity of identifying meaningful performance trends within P&L, balance sheet and cash across 50 to 60 business units was difficult at head office. The costs to management in time and effort of deriving year-on-year comparisons were high. As a result, the company's ability to pinpoint fundamental changes or shifts within sales, costs or cash, or indeed for any other key financial variable within the business units, was limited.

These problems made matters harder for the senior executives, who were keen to focus on shareholder value creation by increasing the economic value of the constituent businesses. They led to the formulation of a number of objectives:

- Establish an information system and reporting mechanism that enabled integration between divisional and business-unit management in the running of their businesses. If, for example, divisional managers were to establish and focus on ways to enable their businesses to compete effectively, they needed a system that captured and consolidated *relevant* information from the business units far more quickly, was scalable in its performance and was fully integrated within the board's reporting process.
- Enable management to spend more time diagnosing and understanding the key business messages inherent within the "wall of reported numbers" than on the formulation and reading of executive reports.
- Create an objective, shared platform of understanding about the performance of business units and divisions among the respective senior management and those at head office. This meant having a fixed set of business analyses that would be used to extract the messages from reported data. The means of analysis would therefore be consistent for all senior managers in the medium to long term.
- Be able to build on this platform of understanding of business performance to establish credible top-down budget objectives for management throughout the group.
- Detect significant year-end risks for any given financial year (risks refer to

the probability that end-of-year performance for a business unit might differ substantially from that which is forecast).
- Be able to diagnose key turning points in financial performance trends and ratios for all divisions and units.

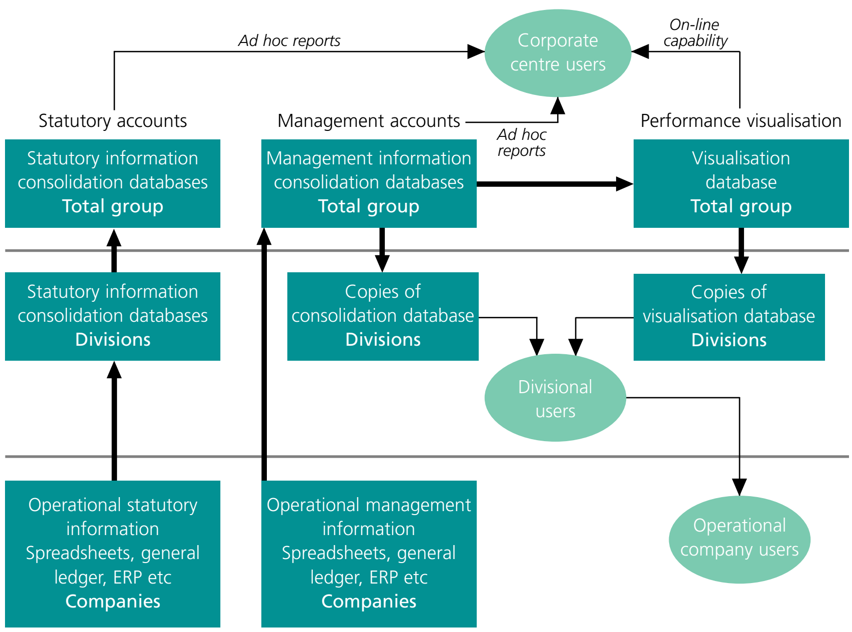
Phase 2 – visualising the key business messages

Tomkins decided to implement a management reporting system that would address the above issues in two consecutive stages. First, an information visualisation capability was added to the existing consolidation systems in 2002. A later development of this system will see the rationalisation of the separate databases into a single group-wide system underpinning both the statutory and management reporting processes. It's expected that this final stage will be completed in 2004.

The first stage of work involved overlaying business visualisation software on the consolidation base (see figure 6, below). The process for the capture and consolidation of information did not change substantially. What did change were the tools that were available to the executive and divisional management for the diagnosis of business-unit performance. Specifically:

- Business performance could be viewed through organisation charts that rapidly identified which business unit had achieved which outcome. This enabled underperforming units to be identified instantly. These "organisational performance" charts could be used to show actual values or variances, for example against budget or previous year. In addition, management teams could gain a more detailed view of business-unit performance by drilling down into the organisational chart.
- Trend analyses of business performance could be used by executive managers to identify, focus on and track key turning points, changes, aberrations or anomalies.
- Comparative analyses gave managers clear visual explanations of the underlying factors behind unexpected performance in the business units. They could also be used to identify the best- and worst-performing units in a division or area (management can drill down into areas of interest or concerns to continue a thread of analysis).
- Business-driver analyses that were tailored to Tomkins' specific corporate objectives and performance drivers showed executive managers the cause-and-effect relationships between both financial and non-financial drivers and business outcomes.
- Significant year-end risks for any given financial year could be detected automatically by means of statistically smoothed trend charts describing business-unit performance and pinpointing implausible movements in any key financial or non-financial indicator; and end-of-period forecasts that could be calculated automatically as a series of management-nominated scenarios for each unit and for key financial variables. Executive managers could then compare these objective assessments of performance against unit/divisional management forecasts to determine any significant variances.

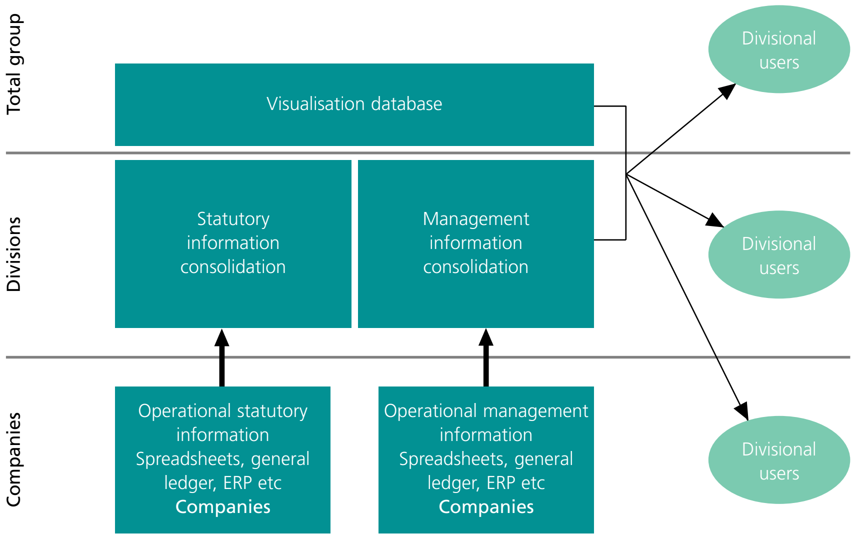
Figure 6 The management reporting structure in phase 2



Phase 3 – an integrated, group-wide consolidation system

The third phase of the roll-out of reporting systems will ensure the integration of disparate statutory and management information systems into a single consolidated system. Overlaid on this consolidation system will remain the business visualisation software that drives key performance data through a series of analyses. Critically, though, the new

Figure 7 The management reporting structure in phase 3



system will create a means for managers to understand what is happening in the business. Tomkins' use of intelligent business systems will allow its management to assimilate the key business messages in the data quickly, freeing them up to manage the business.

Tomkins' success over the past few years has had much to do with the delegation of strategic, operational and financial responsibility to senior company management. Analysis of competitive differentiation has translated into strategy, and strategy has translated into a targeted investment of funds and resources in marketing, operations and support.

The delegation of responsibility to senior company management has been, and continues to be, aided by the development and roll-out of reporting systems and processes. Specifically, the centralised consolidation of data ("hub and spoke" reporting mechanism) has been replaced by a homogeneous, group-wide consolidation and business analysis system. The homogeneity of the new system means that information will be consolidated far more quickly and shared more easily. The advanced analyses within the new system means that both financial and non-financial performance can be diagnosed, shared and understood by a wider management audience.

The homogeneity of the new reporting system, and diagnostic tools within it, will contribute significantly to the successful delegation of responsibility to senior company management. Specifically, they will provide a common, up-to-date platform of business understanding among management and reduce both operational and financial risks in the meantime. ■

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