

Streamlining Non-Financial Performance Reporting

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This paper presents the views of the authors and does not necessarily represent the views of the Office of the Controller and Auditor-General or Audit New Zealand.

1. Introduction

This presentation reviews the reporting of non-financial performance in the public sector. We first outline what is required by statute for reporting non-financial performance in the public sector. Some common issues and obstacles are covered next, and we then provide some ways of moving towards best practice in reporting non-financial performance.

Two specific documents that have discussed the reporting of non-financial performance are the recent discussion document issued by the Institute of Chartered Accountants of New Zealand (ICANZ) and the Third Report of the Controller and Auditor-General in 1999, "The Accountability of Executive Government to Parliament". The contents of these reports are covered briefly.

The presentation closes with some suggestions for keeping performance reporting cost effective.

2. What is required in terms of Parliamentary and public reporting on non-financial performance?

External reporting of non-financial information is governed by the Public Finance Act 1989 (PFA), the Local Government Act 1974 (LGA) and specific entity statutes. These Acts cover accountability requirements for the reporting of non-financial performance.

(a) Departments

In forecast financial statements a department is required to include a statement of objectives (PFA s34A(3)(d)(i)) which specifies the department's forecast non-financial performance for each class of outputs. The outputs within each Vote to be purchased by the Crown are required to be linked to the Government's desired outcomes in the Estimates (PFA s9(2)(f)). The outputs of departments are aligned with Government priorities through the purchase relationship.

In the annual financial statements a department is required to include a statement of service performance (SSP) which shows, for each class of outputs, performance achieved compared to performance forecast in the statement of objectives (PFA s35 (3)(e)). SSPs are included in the annual report of the department and are subject to audit.

(b) Crown Entities

A draft statement of intent (PFA s41C (1)) is required from every Crown entity named in the Sixth Schedule (PFA s41C). This must specify its objectives, the nature and scope of activities to be undertaken and the performance targets and other measures by which its performance may be judged in relation to its objectives (PFA s41D (1) (a to e)). Fifth Schedule Crown entities must specify a statement of output objectives for the classes of outputs to be produced (PFA s41D (1)(h)).

Achieved non-financial performance is reported against the statement of objectives by Fifth Schedule Crown entities. Their statement of service performance must report on the objectives for the classes of outputs produced compared with those established at the start of the year (PFA s41(2)(f)). However, for Crown entities listed in the Sixth Schedule, the requirement to report against the statement of intent is in respect of financial performance only (PFA s41I (a)).

There are further variations to some requirements.

(c) Local Government

The LGA section 223D contains the requirement to prepare an annual plan with detailed information for the financial year and general information for the following two financial years. This information is to include;

- the intended significant policies and objectives (223D(3)(b)(i)),
- the nature and scope of the significant activities undertaken (223D(3)(b)(ii)), and
- the performance targets and other measures by which performance may be judged in relation to its objectives, outputs and outcomes (223D(3)(b)(iii)).

Councils are required to consult the public in the preparation of the annual plan through application of s716A Special Consultative Procedures. The adopted annual plan is required to be made available to the public.

Section 223E requires an annual report, including a statement of service performance, to be prepared and audited. The SSP reports achievement against the performance measures, outputs and outcomes specified in the annual plan.

Effective from the application of the Local Government Amendment Act No.3 (1996), Councils must also prepare and adopt, in consultation with the public:

- a long term financial strategy (LTFS) (at least ten years ahead and updated at least every three years) (section 122K). The LTFS must include the reasons why activities are engaged in (section 122L(b));
- a funding policy (section 122N).

The results of these are required to be reported in the annual report.

(d) What is not specified by statute?

At the moment, statutory requirements focus largely on outputs and a little on outcomes (in the LGA). However, for public entities, other aspects of non-financial performance are important. The capability of the entity to continue to perform in the future is one example. Depending on the nature of the entity, any one of outcomes, outputs or capability may be the most important aspect of performance on which to measure and report, exceeding the other two. Other examples of what is excluded from statutory requirements for reporting are:

- *risk management;*
- *inter-generational issues;*
- *reporting during change;*
- *reporting cross-boundary or cross entity activities.*

3. Some common issues and obstacles (why 'one size' of performance reporting doesn't fit all)

• Who is held accountable for outcomes

The Controller and Auditor-General has expressed in a number of reports the concern that no-one is held accountable for outcomes. Other reported concerns have included vaguely specified outcomes, failure to clarify the linkages between outputs and outcomes, and the absence of a reporting requirement on Ministers to report their achievement of outcomes to Parliament.

The relatively short electoral cycles of local and central government also tend to discourage those elected from being specific about the outcomes they seek. Accountability cycles are annual (for Estimates and Annual Plans) and outcome valuation cycles are of varying lengths in terms of the impacts they seek to establish.

• Differences between reporting for external (Parliamentary/public) and reporting for managerial (internal) accountability

Public sector entities always have at least two audiences to which they are accountable and to which they must report non-financial performance. Managerial control requires operationally useful reports (good quality

information that is timely and for which the benefit exceeds the cost of producing it). External accountability to Parliament or the public requires good oversight information (that provides an overview, meets statutory requirements and is detailed where necessary). Reporting to these two audiences is for different, sometimes conflicting, purposes that may create tensions affecting which data is recorded, analysed and reported. Allowing the differences between these two sets of needs to encourage separate systems of data collection and recording creates further problems.

- ***Few incentives for reporting both good and bad news.***

There are few incentives for chief executives to report more than they are required to. The disincentives to report more non-financial information than required by statute include aversion to generating reactions (media or political) to bad news, uncertainty whether additional information is appropriate, and uncertainty as to the use to be made of extra information or its fitness for such use. Incentives to expand reporting of non-financial information may lie in the extent to which an organisation wishes to publicise its objectives or its vision of organisational direction.

- ***Limited resources***

The size of an entity and, for local government, the urban/rural balance of a constituency often determine the resources available to address performance measurement and reporting issues. Although some kind of differential reporting might accommodate resourcing problems, the rationale for requiring performance to be reported is that communities have a right to know. Small communities have just as much "right to know" as larger constituencies.

- ***Compliance mentality***

Within some of those entities required to report publicly, there is a focus on compliance; that is, reporting non-financial performance externally is regarded as an exercise separate from producing information useful for managing the entity. In some cases this can stifle development for external reporting and widen the gap between what is used for internal management purposes and what is reported externally.

- ***Varying consultation awareness***

Consultation with stakeholders assists in understanding causal chains and outcomes of policies and activities. However, risks accompany consultation. Risks affecting consultation processes include interest groups with conflicting goals, non-representative consultative groups, and varied understanding by those consulted of the language (output/outcome/significant activity, etc.) being used. The process of decision-making after consultation is also affected. Risks include an inability to satisfy all expectations raised and the setting of priorities that do not reflect the wishes of those consulted.

- ***Data archiving decisions***

Good processes and organisational stability are needed to establish high quality databases. Preparers make the decisions affecting the maintenance of data archives. Statutory requirements exist for the archiving of financial data, but performance data may be not maintained, lost through structural change, or maintained as a snapshot rather than recorded over time. In addition,

performance measures change as managers develop their recording systems and measures. The useful aspects of change are better measures, more understanding and better reporting of causes and effects. The negative effects of changed non-financial performance measures are an inability to track performance over time. As change is a constant feature of the public sector, conscious preparer effort would be required to ensure useable data archives survive.

- ***What gets measured gets done***

The overlapping effects of limited resources, the demands for external accountability and a compliance mentality may combine to direct entity attention towards those aspects of non-financial performance that are being measured and reported. The effect of concentrating on reported goals results in displacement of other, possibly comparably important, goals.

- ***General shortcomings in non-financial performance information***

Shortcomings in non-financial information include performance measures that do not cover all of the significant activities, and no clear link between goals and the performance measures by which performance towards goals could be judged. Some benchmarking is being done, but generally for internal information rather than public reporting.

4. Moving towards better practice in external reporting of non-financial performance

(a) Available guidance

Audit Office internal guidelines assist in determining the appropriateness of performance measures. Desirable characteristics of non-financial performance measures are that they should be relevant, complete and understandable.

To be relevant, information needs to be consistent with the agreement between the entity and its stakeholders, controllable by the entity (to some degree) and tailored to the needs of other users through consultation.

Linkages to the entity's objectives, by means of a cause and effect relationship, can be established. Information is complete if it covers all aspects of the entity's performance (for example, outputs, outcomes and capability as well as areas such as risk management) as well as reporting the dimensions of quality, quantity, timeliness, location and cost as applicable. Lastly, understandable information is comparable over time and with other entities. Where applicable, information should meet standards that are generally accepted by a professional group, or similar reporting organisations, as reliable.

Other important factors determining whether data are collected and reported are the extent to which its reporting is timely in relation to decision making processes, and economical, that is, the cost of collection is less than the benefit of providing the information.

Audit Office guidelines also consider it important that the entity reports on the impact (influence) entity activities have had on the area they are seeking to influence. As a minimum, the entity should report which outcomes its outputs are designed to contribute to, and the degree of control it has over the outcome. There should be a link between the long term goals of the entity and

the annual targets demonstrating how the annual targets contribute towards the end goal.

(b) Moving towards better practice in reporting non-financial information

Public sector experience with measurement and reporting of non-financial performance leads to the following suggestions.

- ***Link performance measures to the strategic or long-term objectives of the organisation***

In the course of identifying the strategic or long-term objectives of the entity, what performance means in this context can be agreed. Once the overall objectives of the entity are identified, then shorter-term expectations, together with rewards and sanctions, can be tied to levels of expected performance. This provides the **organisational context** within which performance can then be measured and reported.

Readers of external reports are interested in the strategy development process. Public sector entities that have developed a mission statement linked to their strategy and objectives can then report a package of an overall direction together with non-financial performance information. A long-term focus on planning also enables both financial and non-financial measures to be considered. This type of long-term focus is emerging in statutory requirements for the local government sector.

Outlining this process is not to underestimate the difficulties of undertaking strategic planning and establishing performance measurement. It can be difficult to identify entity goals and objectives, let alone develop non-financial measures of performance. In addition, over time the original mission and strategy require refreshment, as they may change or simply fade. As performance measurement systems evolve, duplication of measures and overlapping systems of measurement will also need to be improved. Finally, there may be multiple and contradictory organisational goals, or an entity's goal may be unclear.

- ***From strategic planning, develop explicit measurements that contribute to management decision-making***

Starting from a planning or strategic focus will provide some guidance as to what is significant for the organisation to achieve in the long term. The value of identifying where the organisation is going lies in the ability to create linkages between long and short term performance, and to address both internal and external accountabilities.

Entities need to address the question, "what change is expected as a result of measuring?" Currently popular models such as the business excellence model or balanced scorecard model are mechanisms for translating strategy into useable measures.

Measurement can be both top down and bottom up. Top level measures communicate overall strategy. Each division or section of the entity can have bottom-up measures that are "owned" by them and understand how the key measures of performance contribute to the overall objectives of the organisation. Incorporation of an emphasis on feed-forward and learning, and periodic review and revision of the measurement system, will assist in the process of developing measurement and reporting.

As before, describing the process is not to imply that it is easy. There are few value-neutral performance measures that will demonstrate unequivocally that

an activity is a success or failure. Performance measures tend to be based on assumptions that interventions or activities will lead to a goal. Beginning the performance reporting process from strategic planning makes explicit those assumptions.

- **Consider key users, including clients, in the development of performance measures and reporting non-financial performance**

Because there are multiple audiences for performance reporting, there are multiple perspectives on information.

Readers

In the public sector, key readers of performance information are not necessarily the same group as those who are receiving or experiencing the service. Readers may be interested in the strategic context and consequent development of key measures. Any development of measures may be easier (not 'easy') if the strategic context is clear and encompasses a full range of influencing factors.

Management

Strategic planning and performance reporting processes need to be driven by senior management but in developing measures, the involvement of those being measured (whether staff or clients) leads to a sense of ownership of the proposed measures, commitment to them and understanding of them. Sufficient detail needs to be provided to internal management and staff for a clear picture of performance, with a reduced level of detail reported externally.

Clients

Performance should be measured in relation to client stakeholder needs and preferences while having regard to the cost which will have to be funded by tax- and rate-payers.

- **Cover a range of dimensions**

The importance of establishing and reporting linkages among outputs, outcomes and capability also varies depending on the type of organisation. Capability-oriented organisations are those where the most important factor about the organisation is the quality and mix of its productive assets. These assets include, but are not limited to, the skills of staff, the development of institutional knowledge and the flexibility of technological adaptability. Performance measures that report on development and retention of the employees, their skill base and capability are useful performance information in which the public is interested.

For output-oriented organisations, outputs are the most important factor. Organisations that are output oriented work under circumstances such that they cannot know, at least for some time, whether their actions have resulted in the desired effect. The important aspect for them is that their actions were carried out, and the eventual outcome may have to be taken on faith. Outcome-oriented organisations are those in which outcomes can be readily identified, and stakeholders are interested in the organisation reporting on whether or not outcomes were achieved; that is, the organisation is clearly oriented towards a goal that can be observed.

- **Multiple sets of measures or a single set of measures?**

There are differences of opinion on developing measures for multiple users. On one hand, limited indicators in key areas are easier for readers to focus

their attention. On the other, the inclusion of all elements integral to what is being measured may provide a richer picture.

In general, entities need to report enough indicators to cater for diversity while limiting reporting to sufficiently few so that the big picture does not get lost.

More measures may be reportable for activities which are "business as usual", with few key measures being reportable for activities in the process of development or change. Future reporting by means of electronic information may permit cascaded information to be available, whereby readers could obtain successively more information as they access more detailed data sets. In the absence of detailed information available through technology, reporting may be limited to the vital few indicators, with these few measures able to report on multiple priorities.

- **Take account of unintended consequences.**

In measuring and reporting on an entity's non-financial performance, the combined effect of the above body of knowledge can be to focus on the stated objectives and devise and report measures directly related to that. In public sector activities, however, activities are likely to have indirectly related effects or consequences other than those directly intended. If unintended consequences are not measured or estimated in some way, reported performance omits information which may be significant to judging service performance. Reporting the full range of costs and benefits of the effect of a policy also gives a clearer picture of its net impact. More formal measurement and reporting, through means such as formal impact evaluation, may be needed to identify all secondary and intangible consequences.

Other consequences and effects may be negative or positive; there may be either unintended costs or benefits; or activities may have been more complex than realised in the start. New policies and programmes may be more exposed to unintended consequences, whereas established policies should be more predictable and capable of being measured.

Examples of important unintended consequences include:

- corruption;
- equity or fairness of determining eligibility for inclusion;
- costs incurred by individuals or organisations;
- other benefits gained by individuals or organisations.

5. Institute of Chartered Accountants of New Zealand (ICANZ) recent discussion paper

In 1993, the Institute of Chartered Accountants of New Zealand (ICANZ) published the "Statement of Concepts for General Purpose Financial Reporting" (SOC). The SOC codified the dimensions of non-financial performance, namely quantity, quality, timeliness, location and cost. In 1994, ICANZ published a financial reporting standard covering the presentation of financial reports. Financial Reporting Standard No 2 (FRS-2) expanded the discussion around an entity's obligations to report non-financial performance and the issue of reporting on outcomes. However, the only mandatory reporting relates to reporting on outputs and the presentation of projected and actual performance.

A working group of the Financial Reporting Standards Board of ICANZ recently issued an "Invitation to Comment: The Reporting of Purchase Performance" (ITC) (July 1999). The document outlines a conceptual framework for reporting information about the "purchase performance" of reporting entities, seen to be of particular relevance to the public and voluntary sectors.

The discussion document has two main implications. First, while not attempting to provide a comprehensive framework of all aspects of non-financial reporting, it focuses on the reporting of performance by purchase agents. Some purchase agents, such as Ministers, who do not currently report their performance would be required to do so formally. Secondly, the document discusses reporting of the reasoning behind purchase decisions. This would lead to more detailed reporting externally of the rationale for purchasing the selected mix of outputs, and would require explanation of how this mix aligns with and contributes to the underlying goals of the purchaser. The ITC does not address issues such as non-financial ownership performance (such as capability, risk management and governance reporting), regulatory performance, environmental reporting, etc. Generally accepted practice on the reporting of non-financial performance information is likely to develop over the next decade.

6. Implications of "The Accountability of Executive Government to Parliament"

In 1999 the *Third Report of the Controller and Auditor-General* on executive accountability identified a number of ways in which executive government accountability to Parliament could be improved. These included the interests of the Crown as owner and purchaser, comments on outcomes, outputs and capability, and the management of risk.

Directions that may lead to solutions that are discussed in our *Third Report* include:

- requiring governments to present a more complete, prioritised set of outcome statements as part of the *Estimates*;
- requiring those outcomes statements to be underpinned by statements that set out how the outcomes will be measured;
- requiring that outcomes actually be measured and the impact of outputs purchased by the Crown be evaluated;
- specifying outputs in sufficient detail, and aligning descriptions of outputs in the *Estimates*, departmental purchase agreements and forecast reports;
- reporting to Parliament useful information on capability, in areas such as human resources, output production methods and information systems; and
- reporting to Parliament about the risks faced by government entities, the steps needed to mitigate those risks and any implications this may have for resources and capability.

Our *Third Report* only refers to central government. Under its legislation, local government must now pay attention to the long-term implications of expenditure decisions and agreed service levels, but measurement and reporting on this information is still developing. Capacity issues are being brought to the fore with the emphasis on asset management planning and identifying the long-term effects of current decisions as to service levels and expenditure. However, there is still little focus on other aspects of capability such as human resource effects and development of use of information technology. Similar developments in central government reporting would provide a long-term focus to performance reporting.

7. Keeping performance reporting cost-effective

- ***Stick to one reporting system***

External reporting should be accessed from the same information systems used to report and assess performance internally. Duplication of systems to maintain sets of data solely for external reporting purposes is expensive and reduces both information usefulness and user acceptance of the reported results.

- ***Routine reporting rather than compliance reporting.***

Non-financial performance reporting is of varied maturity across the public sector. If preparation of the statement of service performance is done as a one-page exercise at the financial year-end, this limits the learning available to the entity from the process. Utilising non-financial data from internal management systems to generate external performance reports allows both feedback for learning and reporting for external accountability to become embedded within institutional knowledge.

- ***Developing a range of measures***

Identifying the movement towards or away from the target outcomes, and designing the output intervention to best achieve the outcome, would ideally be supported by objective measures. But this is not essential. A pragmatic approach is often called for and in many cases it will be more practical to rely on more subjective assessments, including using expert judgements or the views of groups of people. Even with quantitative measures it will still be necessary to use qualitative judgements and tell a story. Analysis cannot replace judgement and debate, but can inform it.

- ***Linking financial and non-financial measures***

Establishing a feedback loop between financial and non-financial performance would generate a complete package of reporting information. In addition, establishing linkages between financial and non-financial performance would strengthen managerial accountability. Clarity of such linkages would also assist in reporting the extent to which decisions affecting the allocation of financial resources were based on non-financial results.

- ***Concise reporting***

There is a sense of having overwhelmed the general reader with too much information. An emerging trend is for concise reports to be issued in newsletters or other forums, especially in local government and at both

Annual Plan and Annual Report stages. However, at present the focus of such newsletters tends to be on financial performance. To provide balance in information available, non-financial performance information should be considered for inclusion. In addition, concise reporting represents aggregated, high-level information, and can serve to encourage readers to seek more detailed information on specific topics.

- **Electronic communication**

The application of technology is likely to deliver solutions in providing information. Alternate solutions to the question of how many documents (and how much information) to report will emerge from single data sources being used to give multiple views of an organisation's performance. Electronic availability of information will eventually do away with the question of the number of documents, through development of search and reporting capabilities to access a single store of data (a data warehouse). Associated measurement and design issues will still need to be addressed, namely recording of the appropriate data and establishing suitable means of access, retrieval and analysis of the data.

- **Cost versus benefit**

Finally, there is the question of cost of disclosure. Managerial accountability should always prefer more information to less (more accountability documents rather than fewer), given a cost-usefulness constraint. External accountability contains an implication that disclosure may be required at some times without considerations of cost, and that the discipline of disclosure and the provision of public information override considerations of cost.

8. Conclusion

There will always be tradeoffs in measurement and reporting. The more non-financial performance information is reported, the more these tradeoffs need to be made explicit, between the costs of reporting and the benefits to readers of reports. This presentation has covered issues of accountability and some common issues that arise in implementing and using non-financial performance measures. We have also outlined some future directions for non-financial performance reporting, including directions towards the development of what is likely to lead to generally accepted practice in this area.

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