

Kevin Brady

Forecasting and Reporting Performance: the Search for the Holy Grail?

Introduction

More than 500 public entities in New Zealand are required to publicly report prospective and actual performance information.¹ Most of the requirements have been in place for more than 15 years, their origins lying in the public sector reforms of the 1980s.

There is strong theoretical logic supporting the usefulness of publicly disclosed performance information, with disclosure of non-financial performance information a growing phenomenon internationally. Indeed, last year I attended an international gathering of auditors-general at which it was clear that the demand for such information is growing.

Yet all of us would have at some time questioned the relevance and usefulness of non-financial performance information. I think we perceive ourselves at a crossroads: needing to decide whether the aim is achievable, and the cost and effort justified by the benefits.

Kevin Brady has been New Zealand's Controller and Auditor-General since May 2002. He joined the Office of the Auditor-General in 1971, and worked in the Napier, Palmerston North, Timaru and Wellington Audit Offices before being appointed to the role of Assistant Auditor-General, Local Government in 1990. He is a fellow of the Institute of Chartered Accountants of New Zealand (ICANZ) and has a Master of Public Policy degree from Victoria University of Wellington.

During the last 18 months my office, in response to statutory changes between 2002 and 2004, has extensively reviewed the prospective information prepared across the public sector. Our conclusion? Despite more than 15 years of experience, there remain significant issues and limitations with the prospective information currently produced, which have an impact on the usefulness of subsequent reporting. I remain concerned that such information is not prepared and reported on as robustly as it ought to be to serve external user needs; nor is it used as well as it might be by internal users – managers and governors of public entities – to improve public service effectiveness.

In this article I want to take the opportunity to take stock and question what we think non-financial performance reporting is for. In doing so, I want to outline what I see from looking across the non-financial performance reports produced by the public sector and the issues I think bedevil the use and usefulness of this information. I want to go back to the fundamental elements and qualitative criteria that underlie the preparation of non-financial performance information. Finally, I want to ask whether some of our expectations are misplaced or unachievable and if so, whether we are seeking a Holy Grail and what a future direction might involve.

So why do it and who needs it?

From more than 15 years experience, I think we can all agree that compiling a meaningful non-financial performance statement presents many more challenges than does preparing a conventional financial statement. Financial statements are heavily prescribed in terms of their structure, composition, measurement and disclosure by financial reporting standards.

There are no such standards for non-financial performance statements, which need to be customised to reflect the nature of the reporting entity. Therefore, judgements need to be made about which outcomes and outputs are most relevant and significant for the purpose of external reporting. It is these judgements that seem to create many of the issues and problems – for both preparers and users.

However, preparing information about entities' performance and the wider impact of this seems inescapable. I've always found it hard to understand why the internal existence and use of such information could be anything beyond commonsense management practice.

Likewise, there are commonsense reasons for the public availability of performance information. Stakeholders are interested in service performance because public sector entities exist to provide goods and services for the public's benefit. However, the vital point about the public sector that underscores the importance of well-prepared performance information is its use of 'coercive powers' to impose taxes or regulate the behaviour of others – powers provided to protect and serve the 'public good'. So a core purpose of public sector performance reporting is to demonstrate efficient and effective service in the 'public good'.

The question of 'who needs it?' has not, in my view, been very well debated. This would involve getting greater agreement about the needs of different audiences and their access to information.

It is obvious for state sector entities that ministers and their monitoring agents are users. However, as part of the governance system for state sector entities, performance information for ministers could equally be provided through 'special purpose reporting'.

Parliament needs information to enable it to hold ministers and state sector entities to account. Parliament is a user required to make decisions about the funds to be voted through the annual Budget process, and to review the performance of the entities that have used these funds. However, the needs of individual MPs vary widely, depending on their individual views, portfolio responsibilities, political alignments and the topical issues of the day.

Of course, we are fortunate to live in a democratic society, in which openness and transparency are the foundations underpinning the use of taxing and regulatory powers. So there are also information users among the media, academics, political and financial analysts and commentators, and interested and concerned members of the public. I too am a user in that I give assurance to Parliament and the public about the performance of public entities.

It is hard to imagine a functioning democracy in which all of these users – and more – don't have a stake, if not in

any single agency's performance accountability, then in the collective quality and availability of this information. The uses and purposes vary but include bringing issues to the attention of the wider community, performing research about the nature and state of our society, identifying the impact of public services, and recommending investment and other decisions.

So could any single set of information meet all these individuals' needs and still address the interests of Parliament and the public? Currently, public accountability legislation tends to provide for one set of information, or a 'one size fits all' approach. While a common set of information might not be of equal relevance to all users, it can provide a starting point from which to explore and question for their

more specific purposes – just as for financial statements the bottom line is the starting point for analysis.

Equally, an issue that we might explore is the different needs and interests of users: how these influence their uses of non-financial performance information, and therefore how information might be provided to better meet different needs. For example, communities making choices about the costs and services provided by their council might require

different information from that sought by the media about the results of policy changes in government departments. An alternative approach might be to require strategic planning to be linked to organisational performance management and communicated in ways that take account of stakeholders' needs and preferences for receiving information. This might provide another way of addressing our desire for service improvement, as well as signalling that information should be based on an understanding of internal and external users' needs.

In recognising that there is a range of users and uses of non-financial performance information, one approach should be rejected – the idea that the purpose of accountability is blame-ability. Out of idle curiosity, I consulted the online Oxford Dictionary, which was surprisingly silent on accountability, but I did find 'accountable', which was defined as 'required or expected to justify actions or decisions', and as 'understandable'. Likewise, under 'account' I found 'a description of an event or experience'.

We are all aware that relationships between outcomes and outputs are complex; that relationships and expectations change over time; and that performance can be influenced by a range of circumstances and events. Non-financial information is perhaps best seen as that which helps make actions and decisions understandable, and explains subsequent events. It is true that sometimes information and its consideration lead to blame, but this is a secondary effect rather than the purpose of information.

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People talk a lot about the need for joined-up government for collaboration, and it seems to me that the key to joining up is to be able to talk openly and honestly in Parliament, the public sector and communities about what we think is happening and how this can be improved. Good quality information, both non-financial and financial, is the oil that allows this conversation.

Perhaps, to quote Rodgers and Hammerstein, I am being ‘a cock-eyed optimist’. Perhaps for many of us who have a part to play in achieving public sector performance, our fear of blame is greater than our desire for gain? I am distressed to hear people questioning the usefulness of preparing non-financial performance information. Perhaps we need to look at ourselves and our behaviour and consider how we create the incentives for true openness and collaboration rather than simply walking away from the challenge of performance information.

Qualities of service performance information

As with general purpose financial information, service performance information is premised on being accurate and relevant for decision making by users. The qualitative characteristics within the Framework for the Preparation and Presentation of Financial Statementsⁱⁱ (relevance, understandability, reliability and comparability) apply to financial reports and equally to service performance reports. Elements to which they apply include the selection of outcomes, outputs, performance measures and targets.

Therefore, overall I expect entities to have a performance reporting framework that reflects the statutory requirements, which in my view would comprise the following:

1. The medium-term component, which should include information on the reporting entity’s objectives, outcomes, impacts and operating intentions, together with related performance measures and standards and other information required by legislation and generally accepted accounting practice (GAAP):
 - clearly identified outcomes and supporting discussion on the entity’s role, functions, strategic priorities, challenges and risks, to provide the context for the entity’s role and functions;
 - main measures and standards for outcomes, objectives or impacts that are clearly specified over a period of three years and provide baseline data that places measures and standards in a more meaningful context and allows progress to be tracked.
2. The annual forecast statement of service performance (SSP) component, which should include information on the reporting entity’s intended outputs, together with

related performance measures and standards and other information required by legislation and GAAP:

- logically aggregated output classes/outputs with clearly specified outputs that are external impact focused;
 - clearly specified performance measures and standards that are relevant and balanced and provide baseline data for measures and standards.
3. A coherent structure and integrated contextual information that makes evident thorough linking within and between the information in the two components:
 - the reasons for the entity’s outputs;
 - the focus of its reporting, including the rationale for, and the relationships among, the elements, performance measures and standards.
 4. And also, of course, the annual historical SSP in the annual report, which reports and explains actual performance against the standards in the forecast SSP.

The state of non-financial performance information

During the last couple of years my office has:

- reviewed most government department and Crown entity statements of intent in depth;
- audited the 2006–16 long term council community plans of local authorities; and
- conducted a performance audit of the statements of corporate intent (SCI) prepared by entities such as council-controlled organisations, state-owned enterprises and Crown research institutes.

Overall, I’ve been disappointed that many entities’ service performance information did not seem to set out coherent performance frameworks showing logical linkages from the medium-term outcomes information and organisational strategies to the annual output information. Neither did it provide well-specified, relevant performance measures and standards for both the medium-term and SSP information.

Of particular concern were the following:

Weak links between longer-term strategy and annual plans

There were weak linkages between the medium-term contextual and strategic information and the annual forecast SSP. These linkages should clearly set out the rationale for the outputs and identify key dimensions of service performance for each output. Assessments of the relevance of performance measures and standards, and subsequent achievements against standards, can be made only in the context of the entity’s operating environment and strategic direction. Therefore, a logical linkage between strategy and service delivery is vital not simply for external accountability, but more importantly for management evaluation and future service planning.

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Identifying service standards

Measures and standards need to be identified and specified for both output information and medium-term achievement. Just as for financial reporting standards, if the underlying elements of the SSP are not properly identified and treated, the usefulness and relevance of information for external accountability, management and business improvement will be undermined. Also important is the need for robust best estimate-based standards combined with historical or benchmark information that gives context to the anticipated achievement.

Through our work we have identified a range of areas for improvement in service performance reports to better meet the expectations laid out in legislation and GAAP. These include a need to better:

- apply the definitions of the elements for service reporting (in particular of outputs);
- consider how to meaningfully aggregate elements to strike a reasonable balance in the extent of detail to communicate a reasonably complete yet succinct and coherent account;
- link the medium-term contextual and strategic information to the annual forecast SSP to clearly set out the rationale for the delivery of service, and also identify key dimensions to service performance for each output;
- identify measures for both medium-term achievement (in terms of the influence or impact sought on the wider state or community) and for output delivery; and
- identify robust best estimate-based standards combined with historical or benchmark information that gives context to the set standards.

In my view, the quality of non-financial performance reporting is a significant weakness in the public sector's accountability to its stakeholders.

I recognise that in 2007 the Treasury undertook a review of accountability documents, and I'm supportive of any initiatives intended to improve the state of information and its usefulness. I confess to some anxiety, however, that undue focus on structural change could displace effort that might have been directed to improving the quality of information – and 15 years of not doing this well is quite enough.

There are wider improvement options that could be considered that are beyond my scope to discuss, but in my – very 'auditor' – view of the world we need to focus on substance over form. By this I mean attention by both entities and central agencies to the quality of information that appears in both forecast and annual reports, rather than simply to its presentation.

Enduring improvement in performance information will require clear and consistent policy objectives, strong central coordination and direction, well-established good management practices, and an unwavering accountability

focus on understanding results. Despite legislation and other high-level accounting and practice guidance, we have struggled to provide this over the last 15 years in the central government sector. One of the things we all recognise is that for performance information to be useful, it needs to be nuanced for, and owned by, the entity preparing it; thus, high-level guidance will take us only part of the way, and improvement is likely to require deeper and more sustained attention.

Non-financial performance reports are essential documents in ensuring government departments and Crown entities are held accountable to Parliament.

Intended work on non-financial performance information by the Audit Office

Over the upcoming year I intend maintaining my focus on performance information, and hope that in tandem with the efforts of central agencies this will help drive the improvement needed in public sector performance information. Indeed, as a result of the legislative changes, and with our

emphasis on prospective service performance information over the last year, we have been reviewing and updating our own audit methodology and standards for service performance information to identify where we too can do better.

I started by noting that many users would say that the information currently produced doesn't meet their information needs, or that it is not understandable for a lay reader. I also noted that entities themselves do not use the information for management and business improvement purposes. Should we be surprised and admit defeat over the challenge of public sector accountability?

Because there are so many users of, and uses for, performance information, there is unlikely to be a silver bullet solution to their complex and varied information needs, and I'm not sure why we would delude ourselves with such a simple suggestion. This is why our public sector accountability arrangements don't rely simply on performance information, but include a range of rights and means to obtain information for the range of users.

My own view is that the very diversity of expectations and uses of performance information is part of what bedevils it – and so long as we continue to expect it to answer every question, non-financial performance information will remain a quest for the Holy Grail. I recall still that when the legislative requirements for SSPs were first introduced, some individuals in central agencies thought there would be no need for other work such as the performance audits my office undertakes because all the information would be in the SSP. We are a long way now from thinking that that kind of information can appear in one statement – but no further advanced in having a better answer to problems of service performance improvement and accountability. Despite the

obvious inherent tensions and flaws, neither the 'status quo' nor the 'abandon' options appear tenable. So we need to knuckle down with this, in my view, not fully implemented part of the reforms, and genuinely give non-financial information the consideration it deserves, in the spirit it deserves – be we preparers, reviewers or users.

Many people don't understand a set of financial statements, but that doesn't discredit the value of the information or its purpose. Likewise, while we should endeavour to ensure service performance information is well expressed in commonly used language, we should also expect the reader to come to the information moderately informed and willing to make the effort to understand it.

The question of the use that entities make of their service performance information is a little more perturbing. By way of parallel, what confidence would we have in an organisation that said it did not use its financial information for management and business improvement purposes?

The preparation of service performance information should be the reflection of good management practice involving clear articulation of strategy, linking of strategy to operational and other business plans, monitoring of the delivery of operational and business planning, and evaluation of strategy impacts and results.

Non-financial performance reports are essential documents in ensuring government departments and Crown entities are held accountable to Parliament. Parliament and the public rely on these documents. If those documents report poor performance, democracy requires departments to be held accountable for ensuring they remedy performance issues. If Parliament is unable to adequately assess entity performance because of the poor quality of performance reporting, then we would expect those entities and their oversight agencies responsible for the quality of reporting to be held accountable for their inadequate reporting.

I note again that here I speak not of blame but of making actions and decisions understandable, and explaining subsequent events. I speak not just of demonstrating accountability, but of achieving continuous improvement in public sector effectiveness.

While there are some good examples, these are in my view too few and far between. The only thing I can generally say about the state of performance information currently is that there is a level of public information about government departments and Crown entities and their services.

Addressing the weaknesses in performance information requires greater clarity, persistence and consistency at a government and public sector-wide level. As long as the weaknesses I've described persist, parliamentarians and the public can have limited assurance that the performance information of public entities reflects the purpose and impact and effectiveness of their endeavours.

i This is an edited version of a paper presented at the 'After the Reforms' symposium in Wellington, 28-29 February 2008, hosted by the School of Government at Victoria University.

ii The standard adopted by the International Accounting Standards Board.

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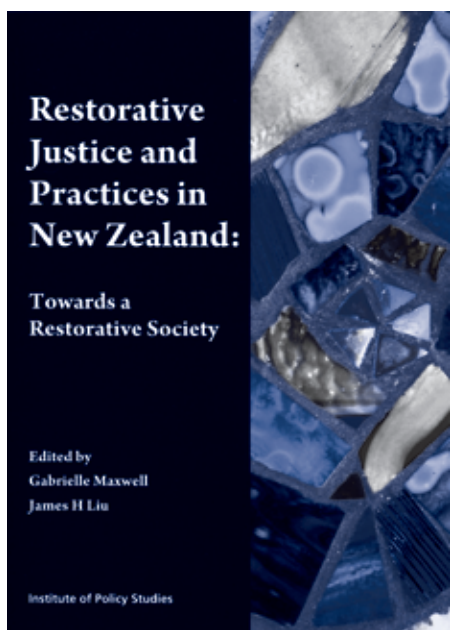
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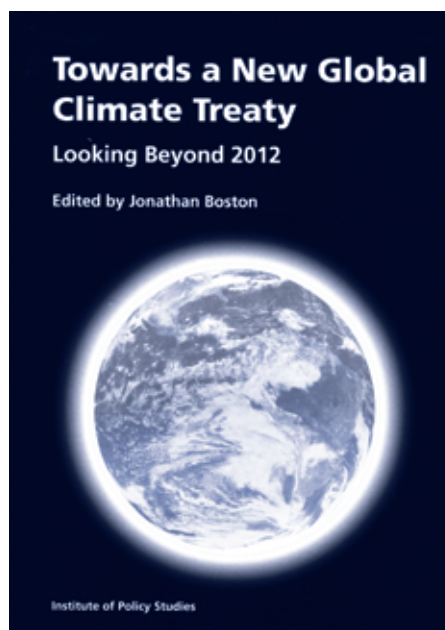
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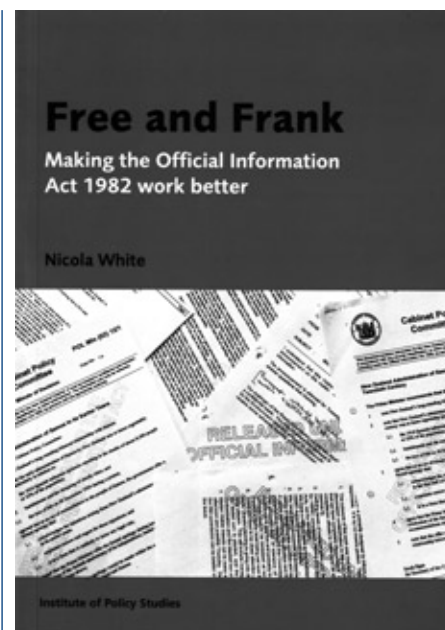
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By Nicola White

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