GEOFF WILLIAMS BELIEVES HE'S HIT ON A BETTER WAY OF REPORTING BUSINESS PERFORMANCE FOR SMEs.

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Towards better management reporting

There is widespread concern right now about the increasing compliance workload for the accountant in public practice in Australia.

"Despite all the warning signs … [the government is]…paying not the slightest regard to practitioners' physical and mental capacity to cope with the unprecedented scale and speed of change." (see, for example, Michael Inglis on Tax in February *Charter*). It is therefore important that the introduction of the consumption tax (GST) and the Ralph Report legislation do not inhibit the supply of value-added services. The GST legislation in particular is based on each business entity acting as a tax collector, and may entail client resentment about the increasing cost and decreasing benefit for the client.

However, one value-added service that accountants can provide is management reporting: either providing the service directly to clients on an annual or monthly basis, or advising clients on developing their own system of management reporting.

Important recent trends in management reporting have been:

- ♦ the inclusion of operations data, and
- ♦ the generation of updated forecasts

Operations Data

The inclusion of operations or non-financial data has coincided with the spread of interest in the balanced scorecard approach for business performance reporting.

The January 2000 issue of *Strategic Finance* quotes a Gartner Group report that at least 40% of *Fortune* 1,000 companies will be using the balanced scorecard (BSC) by the end of this year.

The same article quotes the Institute of Management Accountants' Cost Management Group as having conducted two surveys and reporting that 22% of respondents currently use the BSC approach, and 18% plan to use it. The survey respondents claimed that BSC provides a better understanding of operational factors such as timely delivery and defect rates that impact on financials, as well as a better understanding of customers and markets.

The BSC approach concentrates four different dimensions of company performance into one report:

♦ financial ♦ customer ♦ internal business,
and ♦ innovation/growth

Goals and corresponding performance measures are listed for each dimension, based on a strategic vision for the organisation.

In Australia some useful benchmark data is included in the annual *FMRC Business Benchmarks*, which emanated originally from the University of New England, Armidale, NSW. Their data has a financial emphasis, not related to the BSC approach.

An important article by Roger Juchau in *Charter* in February this year summarises the results of a survey on the use of non-financial performance factors in setting company goals. His conclusions indicate the importance of some non-financial factors, and the gaps in reporting them.

BSC appeared to me to be a little sophisticated and expensive for small and medium sized enterprise (SMEs). Consequently I have sometimes taken a different approach. The main groups of personnel with which an SME is

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interacting, plus growth, are listed as categories:

♦ customers ♦ shareholders ♦ financiers
♦ suppliers ♦ employees ♦ government, and
♦ research

Performance measures are then sought for each category. Selection of data based on this guideline has been relatively simple to implement, in my experience.

For example, reports for a medical practice may include the following operational data:

- Clients: numbers of new patients, deaths, HIV cases, accounts overdue
- Employees: staff additions/terminations, overtime hours
- Suppliers: deliveries overdue
- Financiers: loan repayments overdue
- Government: tax & superannuation & insurance returns overdue
- Growth: training course hours

The reporting model to be used needs to be flexible to allow for easy changes in the operations data selected for reporting, as management concerns vary over time.

There has been a definite benefit in my view in highlighting significant operational statistics, as well as financial statistics, at board level: in particular, the non-executive directors have an improved perspective of the business.

For example, statistics on monthly lost time, machinery breakdowns and security breaches give the board of directors a wider perspective of business activity and facilitate earlier decisions to remedy adverse results. A better informed board is a more supportive board – and a more decisive board.

Updated Forecasts

The second change in producing management reports has been the introduction of regularly updated forecasts in management reports.

The reports I use compare budget and actual data, and show a variance for comment, and then a forecast of the expected result at the end of the financial year compared to the budget for the full year. Forecasting is integrated into the regular reporting system, not treated as an occasional effort.

The position taken is that the accountant not only counts the beans, and the cost of the beans, produced this month and year to date, and compares these to budgets for this month and year to date. The accountant also estimates the beans and the cost thereof to be produced for the full financial year, based on actual to date plus forecast, and compares these figures with the full year budgets, for the full financial year. This is done efficiently and securely each month for clients.

The use of forecasts is consistent with the accountant assuming a navigational role, and has the following benefits, in my experience:

- early warning of crises: for example in a very seasonal business, cash deficits in seasonal low points are quantified as best as information permits, and the need for assistance is clarified
- advance indication of surpluses for investment, and for how long they are expected to last
- facilitation of early corrective action, by estimating the effect of taking alternative actions in advance, action to follow a change in stocks, or greater overtime, for example
- preparation for changes in parameters

An example of this last benefit has been the use by me of the management reporting model as a corporate planning tool, to measure the effect of the new Australian consumption tax on a business entity from 1 July, 2000.

It is useful to provide a quantitative estimate of the new taxes payable under accrual and cash accounting assumptions, and to show the effect on the business month by month. The taxes below as an example amount to about 20% of the entry's profit, in magnitude:

Profit Statement		GST Statement	
Sales	1,000,000	100,000	10%
Costs: taxable	600,000	- 60,000	10%
Depreciation, wages	200,000	0	
	800,000	60,000	
Profit (no income tax)	200,000		
Consumption Tax for the year			
(% related to profit)		40,000	20%

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The above example is based on there being no fixed asset expenditures or sales for the year. Although not a charge against profits for the year, the consumption tax in the example above amounts to a very significant amount when compared to both the profit and the net cashflow for the year. It is preferable to be aware of the magnitude of these figures in advance.

The consumption taxes forecast using the model above can now be included in a budget for the year ended 30 June 2001, and can be a control against which to measure GST payable to ensure returns are made correctly.

To sum up, monthly reports which include:

- operational data as well as financial data, and
- updated forecasts of year end results

help directors' decision-making. The board gains an improved understanding of internal business processes and the marketplace. The effect of alternative actions may also be estimated for the board.

Both innovations provide an opportunity for genuine value-added contribution by the accountant. In the current climate of considerable business change and uncertainty, I believe it is important that tax compliance pressures do not cause accountants to contribute less to SMEs' business performance.

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