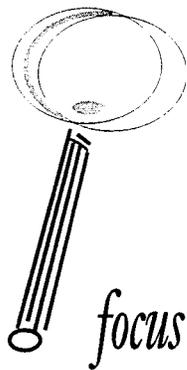


# 1

## Improving Management Effectiveness Through Reporting



### Learning Objectives

By the end of this chapter, you should be able to:

- Describe the revolution taking place in financial reporting.
- Identify how to increase the relevance of information provided by your financial reporting system.
- Explain how computerization has changed the financial reporting function.
- Identify four benefits of effective reporting.
- List ten principles of an effective reporting system.

### INTRODUCTION

Pundits suggest that the dawn of the twenty-first century has ushered in the information age. In the future, an organization's success will depend in large part on how well it collects, processes, and uses strategic financial information. In the past few years, business managers have realized that antiquated reporting systems do not deliver the type of timely and relevant information that allows companies to be competitive in the global marketplace. This course considers how to design or redesign an organization's financial reporting system to achieve maximum efficiency and effectiveness.

Effective reporting is the art of providing management with the information it needs to run the business. Financial reporting involves a broad spectrum of reports that provide financial information for processing transactions, budgeting, and making management decisions. Even reports dealing with inventory, job performance, and production are ultimately financial—they all affect the bottom line.

Managers increasingly have become aware of two facts. First, quality, customer satisfaction, and resource management are as important to profitability as basic cost controls. To meet these qualitative goals, however, managers must be able to measure them. Second, financial reporting systems that provide only traditional historical accounting information have failed to help companies stay afloat in today's more competitive business environment. Consequently, reporting systems are being redesigned to provide relevant financial and nonfinancial information on a more timely basis.

## THE "REVOLUTION" IN FINANCIAL REPORTING

Businesses collect financial information for both external reporting and for internal decision making. External reports include financial statements that are provided to shareholders, creditors, the government, and other interested external users. Traditionally, many financial reporting systems stressed external reporting over internal management reporting. This emphasis created a bias toward historical costs and last year's results rather than a needed focus on current data and financial projections. Historical data have proven to be less useful to managers than accountants once assumed. Fortunately, the emphasis on historical financial information is changing as managers realize the importance of timely, relevant information.

Flexibility was not always the watchword it is today. Yesterday's watchwords were advance planning, budgeting, and control. The whole concept of responsibility accounting assumed that managers could calculate optimal results. Traditional managerial accounting systems stressed the calculation of an optimal sales mix of products at optimal levels of production. These traditional cost accounting systems often produced misleading results because of distortions in the allocation of overhead. Overhead often was based on the rather arbitrary number of units sold or produced. Traditional reporting systems also stressed the discovery of deviations, or variances, from optimal cost projections. Underlying this view of business management was the assumption that the business would remain relatively static.

Modern reporting systems have eliminated distortions in overhead allocation through the use of activity-based costing (ABC), and managers now recognize that few businesses that remain static can survive in the increasingly competitive global environment.

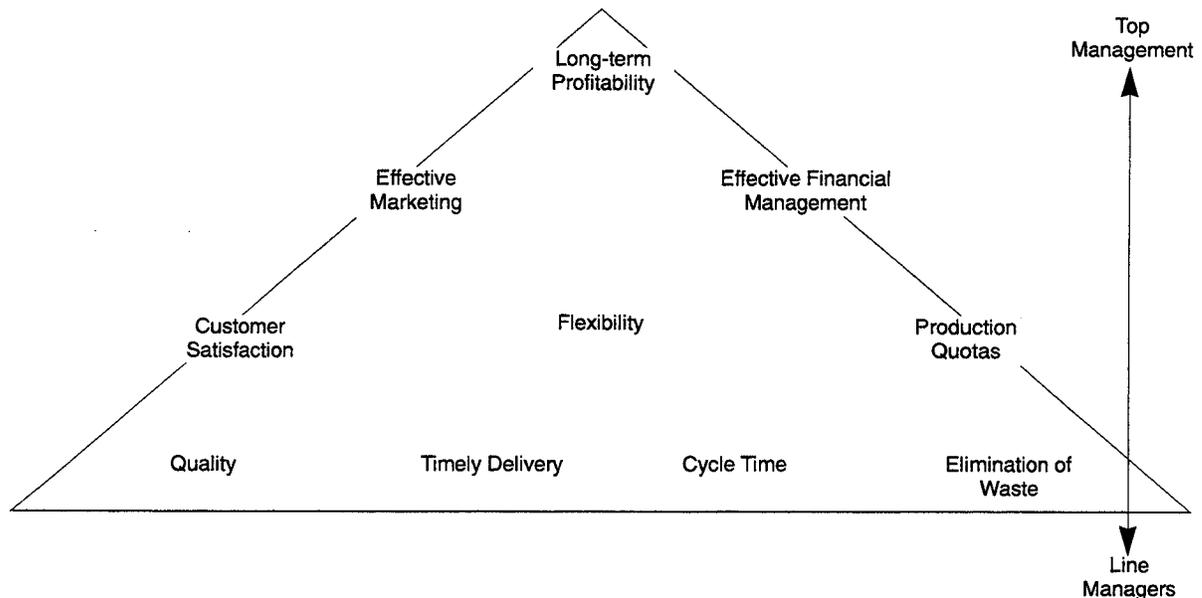
## INCREASING THE RELEVANCE OF REPORTING

Managerial emphasis has switched from controlling costs to providing more relevant information, including nonfinancial performance measures, that can help managers in their daily decision making. The old emphasis in reporting was on keeping score of operating results; the new emphasis is on providing information that will increase innovation and flexibility.



## Exhibit 1-1

### Importance of Financial Reporting Systems



In a traditional reporting system, a production manager in a manufacturing operation might receive a June variance report some time in July. The manager would learn that a particular cost component deviated from the optimal standard, but coming so late, the information was not particularly useful and certainly did not suggest ways to improve quality or productivity. At worst, the standard cost system might send the wrong signals.

Prior to the introduction of just-in-time (JIT) inventory systems, existing standard cost systems often reported low labor utilization and productivity when, in fact, the companies had excess capacity. The reporting systems supplied information that was irrelevant and misleading.

Reporting systems are now being designed to provide more relevant and timely information. As Exhibit 1-1 illustrates, while higher-level managers are more concerned with the abstract concepts of profit and loss, line managers are concerned with nonfinancial information that helps them do their jobs. Managers need to receive specific information about quality, waste, lead-time, work in process, and other nonfinancial measures that can help them increase productivity and profits.

### EFFECTS OF COMPUTERIZATION

Reports are vital tools for the communication of information. In modern organizations, information is management's most important resource. The growth of management reporting corresponds with the growth in the size

and complexity of business. In response to the need for considerable amounts of information, computers have allowed businesses to collect, sort, and deliver almost limitless amounts of data. Information flow has increased so dramatically that: many managers now complain of information overflow. Concise reporting of pertinent information consequently has become one of management's most valuable tools.

### Information Overflow

Computerization has made it possible to develop, produce, and disseminate massive amounts of information in minute detail. Unfortunately, large volumes of data alone are of little use and can be counterproductive. For example, a manager might request that the accounting department provide more data about late shipments. If the accountants' response is to provide a 50-page spreadsheet that requires the manager to spend 30 minutes to extract the needed information, the effort is counterproductive. What the manager needs to solve the problem is a report specifically focused on late shipments.

In some cases, computer-generated reports may even hinder management in its efforts to run the business, especially when only management information systems (MIS) personnel are allowed to determine the nature, amount, and format of reported information. Many MIS installations do not focus on creating reports designed to sharpen management's decision-making and control abilities. If management itself does not carefully direct and control the output of information, even MIS installations that do focus on critical decision areas will not be able to exercise selectivity in what information to report, and important facts will get buried among insignificant ones.

### Data Versus Reporting

The availability of low-cost computing power allows an organization to generate massive amounts of information in various formats. Information is not especially valuable: unless it is presented in a form that is immediately useful to users. Computer systems allow organizations to access vast amounts of data-dollar amounts, quantities, and dates. By themselves, data cannot easily be used for decision making.

Reporting is different from data generation. Reporting is the process of communicating information. Reporting requires the summarization of data in a way that will provide useful information to the user.

Too many financial managers confuse data with reporting. For example, one manager at a medium-sized manufacturing plant complained that he lacked the critical information needed to manage a particular production task. In fact, the manager received reports that contained the needed information, but the relevant facts were buried within 20 pages of weekly spreadsheets. Although the spreadsheets provided lots of data, the spreadsheets failed as reports because they failed to communicate the relevant information needed by the user.

It would be unfair, however, to blame the computer for all of the problems associated with reporting when the need for more effective and efficient

reporting existed long before the widespread use of the computer. Nonetheless, the computer does highlight the need for more effective reporting. When computers were first introduced into business, managers concentrated on automating the preparation of their reports. What managers should have done was to evaluate whether the old reports were worth preparing at all. In a less complex era, managers could wade through available information to find the data they needed even if the reporting system was poorly designed. With today's greatly increased information flow, an inefficient reporting system can drown managers before they find what they need.

## BENEFITS OF EFFECTIVE REPORTING

When properly designed, reports serve an invaluable management function. They allow managers to make well-informed and timely decisions that help achieve organizational goals. Armed with accurate financial information, managers can avoid making decisions solely on intuition. The result is more effective operations and increased profits.

The ideal reporting system would tell managers everything they need to know and only those things. Although no such ready-made system exists for every application, an effective management reporting system that will lower costs and reduce information overflow can be developed for each company. Companies will experience at least four specific benefits with an effective reporting system: increased communication, increased productivity, more accurate planning and forecasting, and timely evaluation and control.

### Increased Communication

The first benefit of effective reporting is that it creates a communication channel to send information upward, downward, and laterally. A report can be designed to transmit information in whatever direction needed. For example, reports can communicate across an organization at various levels. Items that were reported separately can be disseminated in the form of a compiled report, allowing data to be compared laterally. One department may need to know the sales figures of another department, even though that information normally is reported only vertically. In addition, some reports might be sent directly to a parallel level of an organization to facilitate coordination.

Another slightly different aspect of the communicative value of reporting is that a report can communicate in more than one direction at the same time. With a properly conceived reporting system, information flows down and across as well as up the organizational ladder.

A report request itself is a communication tool that carries a message to the preparer before the response is even completed. Merely requesting that certain information be included in a report communicates the report user's concern with the information. The preparer will discern from the required detail, frequency, and areas of emphasis the amount of interest the user has in the particular data.

## Increased Productivity

The second benefit of effective reporting is increased productivity. To be productive, organizations must be flexible enough to respond to changes in the competitive environment. Unfortunately, traditional accounting systems are often counterproductive in this regard, sending production departments the wrong signals. For example, based on optimal levels of production, indirect costs can be allocated arbitrarily, distorting the company's profit picture.

Progressive financial managers now recognize that financial reporting systems must be redesigned to provide more useful information to managers. Concepts such as total quality management (TQM), just-in-time inventory systems, and an emphasis on service and customer satisfaction cannot be implemented unless the financial reporting system supplies performance measures other than traditional cost and performance variances. Businesses that have embraced activity-based costing and that have access to nonfinancial data have seen dramatic increases in productivity because managers make better decisions with the accurate and reliable information given to them.

## More Accurate Planning and Forecasting

Accuracy in planning, budgeting, and forecasting is to a great extent dependent on the appropriateness, timeliness, and accuracy of reported information. Complete and accurate current and historical financial data are the basis for forecasting and budgeting. Short-term cash forecasting is especially dependent on timely reporting. Thus the third benefit of a good reporting system—more accurate planning and forecasting—is extremely important to running a profitable business.

Effective management requires strategic planning, but strategic planning concepts were developed when many of the key features of the market environment were more stable and could be anticipated with some certainty. As uncertainty becomes the rule in medium-term investment markets, foreign competition, international currency fluctuations, and surprising technological developments, strategic planning becomes difficult. However, once top management sees uncertainty as an information problem that can be managed, strategic planning can continue. Better, more current information may well be the solution to reducing paralyzing uncertainty to a manageable level. Efficient reporting of both internal and external factors can diminish the need to make unfounded assumptions, allowing for quick shifts in response to a changing business environment.

For example, many manufacturers, notably U.S. automakers, have worked to decrease the time required to develop new models. A company's financial reporting can either help or hinder such an effort. To respond quickly to changing markets, managers need not only up-to-the-minute information about the company itself but also accurate information about competitors and market conditions.

## Timely Evaluation and Control

The fourth benefit of an effective reporting system is timely evaluation and control. For example, a manufacturing company that discovers that it currently is selling several products at a loss may have a defect in its reporting system. The data needed to avoid this situation already may have been collected and contained in several spreadsheets, but the pertinent information may not have been presented in a useful form. It must be channeled so that those in control can make timely decisions.

Even managers who have direct contact with every one of their operational areas may not necessarily have the detailed facts and figures needed for comparisons and evaluations that can be derived from effective reports. In a broad sense, evaluation and control at all levels are based on reported information.

## PRINCIPLES OF EFFECTIVE REPORTING

As much as managers would sometimes like to eliminate reports, they must admit that reports form the basis for the transmission of information. The challenge is to make reports effective tools that provide decision makers with the right information at the right time. The only way to accomplish this goal is to implement an effective management reporting system. Such a reporting system should be a network for information flow designed for the particular organization. This network must be continuously maintained, updated, evaluated, and controlled just like any other major functional area of an organization.

Whether an organization starts from scratch or improves an existing system, ten basic principles, if followed, will make the system more efficient and effective. These ten principles (see Exhibit 1-2) apply to the design of all systems and reports discussed in this course.

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### **xhibit 1-2**

#### **Ten Principles of Effective Reporting**

1. Make it useful.
  2. Make it clear.
  3. Make it simple.
  4. Make it comprehensive.
  5. Make it relevant.
  6. Make it include commentary.
  7. Make it appealing
  8. Make it accurate
  9. Make it timely.
  10. Make it cost-effective.
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In general, these principles apply to both small businesses and large corporations. They also apply in most cases to both manual and automated systems. In fact, a well-planned manual reporting system can be converted readily to a computer-based one; the principles underlying an effective system serve both applications.

### **Make It Useful**

A report should be useful to the user. Every report should be based on a clear purpose defined by the user. The user is the person or office that requests and needs the information. The preparer is the person or office that provides the information by putting together a report or filling out a form. The user and the user's supervisor know what information actually is needed. From time to time, users should be asked if the reports should be changed or even eliminated. Usually, the user's supervisor is the best person to identify and eliminate unnecessary reports.

Generally, a report should not be initiated by the preparer because the preparer is not in the best position to know what information really is needed. He or she may have too much to gain by preparing unnecessary reports that only add to the workload and publicize the activity. On occasion, the preparer may have something to report that the user needs to know but has not requested.

Within the constraints of any established company standards, the user's preference should prevail on questions of format, content, detail, narrative, solutions, and analysis. The user should be allowed to control these elements of the report format. Consequently, report forms usually are designed by the users.

### **Make It Clear**

A report should send a clear, definite message, and the language of the report should be straightforward. When a report focuses on one major point, its purpose is clear to the preparer. When the preparer understands the purpose of a report and its possible uses, the response is more likely to be cooperative and accurate.

Language in the report should be common to both the user and the preparer. Accounting jargon should be avoided whenever possible. Standard terminologies should be used along with proper forms, headings, and subheadings.

### **Make It Simple**

The form and content of a report should be kept simple. Standardization of terminology, units of measurement, rounding-off practices, and particularly formats helps to increase understanding and thus to simplify reporting procedures. The entire management reporting system should have uniform and consistent classifications of accounting practices and terminologies.

Graphic presentation of data can have more impact than rows of numbers. When a report solicits information, it should be easy for the preparer to

see just what the user is requesting. It also should be simple to see what form the response should take. When a report requires responses from a number of people—for example, as in a questionnaire—responses should be limited to a number, a word, or a checkmark.

### **Make It Comprehensive**

A report should be comprehensive. Comprehensiveness does not contradict simplicity. Report writers can simplify to a fault. A report has little utility if it does not contain sufficient detail to answer the question that was asked originally. Everything that needs to be reported about the subject should be included in one shot. Otherwise, another report may be required.

Report writers should remember that each higher level of management needs less detailed information about day-to-day operations. A method of reporting that illustrates this principle is the pyramid approach, which adopts the following rule: The level of detail in a report should vary with the level of management. Detail is condensed as the report is prepared for successively higher levels of management. For example, the clerk worries about the daily amount of cash in the till, the sales manager is concerned with the monthly gross sales, and the owner wants to know the quarterly net profit for the entire operation.

### **Make It Relevant**

A report should be relevant to the user, and items in the report should pertain to the purpose. The focus should be on providing nonfinancial as well as financial information. For example, users should not request information that does not relate to their areas of responsibility, and preparers should not offer irrelevant data. Even relevant items should not be reported when they are really immaterial.

One way to ensure that a report is relevant is to use the report-by-exception method. An exception report covers only pertinent items that are outside of a defined norm. In this approach, only exceptions are considered relevant. This method allows management to focus on those items that particularly need attention.

Reports can outlive their usefulness. A report with a "sunset" provision will be scheduled for elimination at a set date unless steps are taken to continue it.

### **Make It Include Commentary**

A report should allow for narrative analysis. Although narrative reports can be entirely subjective and, therefore, relatively useless, many responses to questions require some explanation. Ruling out narrative comments may prevent the preparer from giving the most important information. Often words can convey a message more effectively than numbers alone. The preparer's perspective and explanation can be invaluable in understanding exceptions and variances.

### Make It Appealing

A report should appeal to the eye to command the reader's attention. This principle applies to both the user and the preparer. The user should suggest or provide a simple, direct format. Areas that require responses should be highlighted and grouped when possible.

Type styles and layout should be considered. White space should be used effectively. Whenever possible, graphs or charts should be used in addition to, or in place of, a table of figures to illustrate a point. The goal is to maximize the impact and usefulness of the information.

### Make It Accurate

A report must be accurate. The user of the information must ask for exactly what he or she needs. Internal and external cross-checks can be used to verify the information received. The tradeoff of increased time and cost against increased accuracy and detail, however, should be weighed beforehand. In any case, the preparer at a minimum must always provide the best information available. Accurate reporting of even the least complementary facts and figures is in the best interest of the company in the long run.

### Make It Timely

A report should be current and timely. Information is valuable only if it can be put to use by the organization. The entire reporting system should be reviewed periodically, especially if the company undergoes a reorganization. An ongoing method of review should keep the reporting system a vital, flowing, up-to-date information network.

Reports must be submitted immediately when a critical situation occurs. Flash reports (see Chapter 4) and oral reports should be used when appropriate. Estimates and approximations should be used when permissible to speed up the reporting of hot items. And, finally, time schedules and deadlines should be established and enforced for all reports in the system.

### Make It Cost-effective

A report should be cost-effective. The cost of reporting should not exceed the benefits likely to be derived from the report. Managers need to determine the real value of each report. One way to save money is to eliminate or consolidate existing reports. The required frequency of submission can be extended, and sunset provisions can be implemented (a report with a sunset provision has a specified extinction date beyond which the report must be renewed).

## SUMMARY

Financial managers realize that to keep their organizations competitive they must increase the relevance of the information provided by their financial reporting systems. Many companies are redesigning both their reporting sys-

tems and their computer systems. Computerization has made profound changes in financial reporting. Merely automating manual tasks does not create an effective reporting system. At worst, it can create information overflow. The goal should be to increase the effectiveness of the reporting system. There are four major benefits of improved reporting: increased communication, increased productivity, more accurate planning and forecasting, and more timely evaluation and control.

Effective management is dependent on a variety of factors, the most important of which is timely, accurate, and relevant information. A critical analysis of most information reporting systems will uncover areas where improved reporting could provide management with increased ability to make wise decisions.



## **Review Questions**

1. Traditional reporting systems put the lowest emphasis on:  
(a) internal decision making.  
(b) external reporting.  
(c) historical information.  
(d) last year's results. 1. (a)
  
2. Responsibility accounting:  
(a) is a recent development.  
(b) assumes managers can calculate optimal results.  
(c) does away with the need for variance', analysis.  
(d) ignores or deemphasizes cost controls. 2. (b)
  
3. Information overflow:  
(a) is a characteristic of manual reporting systems.  
(b) is often eliminated by computerization.  
(c) cannot be controlled.  
(d) promises to accelerate with computer networks. 3. (d)
  
4. Reports differ from data in that they:  
(a) are less concise.  
(b) focus more closely on dollars or quantities.  
(c) summarize information for the user.  
(d) are generally less useful to operating managers. 4. (c)

5. The person in the best position to evaluate the need for a new report is the: 5. (a)
- (a) supervisor of the requester (user) of the information.
  - (b) requester (user) of the information.
  - (c) supervisor of the preparer of the report.
  - (d) preparer of the report.
6. In an effective reporting system, information generally flows: 6. (c)
- (a) up the organizational ladder.
  - (b) down the organizational ladder.
  - (c) in several directions at once.
  - (d) up or down, but only in one direction.
7. The pyramid approach to reporting: 7. (c)
- (a) suggests that upper-level management should be closely involved in day-to-day operations.
  - (b) works up from monthly reporting at the lowest level to daily reporting at the top level of management.
  - (c) provides less detailed information as it moves up management levels.
  - (d) compiles increasingly detailed information as it moves up management levels.
8. The best person to determine the format of a report is the: 8. (d)
- (a) chief financial officer.
  - (b) chief of operations.
  - (c) preparer.
  - (d) user.
9. A report in which items are reported only when they go outside a defined norm is called a(n): 9. (c)
- (a) overhead report.
  - (b) deviation report.
  - (c) exception report.
  - (d) normal report.
10. A report with a "sunset" provision expires: 10. (d)
- (a) daily.
  - (b) quarterly.
  - (c) monthly.
  - (d) at a predetermined time.

