

**PERFORMANCE REPORTING BY  
UK CHARITIES: APPROACHES,  
DIFFICULTIES AND CURRENT  
PRACTICE**

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Published by  
The Institute of Chartered Accountants of Scotland  
CA House, 21 Haymarket Yards, Edinburgh EH12 5BH

First Published 2003  
The Institute of Chartered Accountants of Scotland

© 2003  
ISBN 1 871250 97 8

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Printed and bound in Great Britain  
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The Research Committee is grateful to all those who participate in the refereeing process.

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## FOREWORD

It is not just the Chancellor of the Exchequer who has stressed the importance of charities to the social fabric of our society. Our high streets reflect the everyday fund-raising role of many of the larger charities, which have increased prominence in the public eye and attract a greater level of public interest. The public does not just want to know that there is no money missing – but wants to know that charitable funds are used wisely and well when deciding whether or not to provide support.

In recent years the accounting burden on charities has increased significantly as a result of much greater pressure on them to demonstrate that their financial stewardship has been appropriate, with significantly greater accounting and disclosure requirements emanating from the Charity Commission and reflected in the Statement of Recommended Practice for the sector. Although this has increased the accounting information provided by charities very substantially, it has done little to help show the operational effectiveness of charities or enable any assessment to be made of their performance in achieving their objectives. Instead, the focus on more financial accounting information is often at the expense of emphasis of their goals and aims, without which it is very hard to frame a context in which to understand and interpret their reports.

Performance measurement, against relevant and clearly defined goals, is a difficult and complex task. There are no easy answers, and for each charity the best choices are likely to be different. However, if time and effort are invested in developing such goals and then measuring

and monitoring the achievement of them, there can be considerable benefits. Such a framework helps encourage better planning and control within the charity itself, and that process itself can create a virtuous circle by helping the charity to meet its goals. Measuring and reporting a charity's performance in this way can increase the attractiveness of the charity for potential contributors, since the report allows it an opportunity to show its effectiveness and efficiency. Indeed all categories of stakeholders find themselves better able to gauge the true success of the organisation, because all recognise that effectiveness cannot be measured solely in monetary terms.

The Research Committee of The Institute of Chartered Accountants of Scotland is pleased to have funded the research that underlies this publication. We hope that it will help and stimulate charities in developing and improving their own performance measurement and internal and external reporting. We believe that those charities which are able to demonstrate that they are efficient and effective in meeting their objectives are the ones with the best possible chance of attracting increased financial support for their ongoing work.

Nigel Macdonald  
Convener  
Research Committee

July 2003

## **ACKNOWLEDGEMENTS**

The authors wish to express their gratitude to all the UK charities that provided annual reports that formed the basis of the empirical study in this report. Furthermore, we would also like to thank The Institute of Chartered Accountants of Scotland for the financial and research support for this project, and three anonymous referees for their very helpful comments.

## **ABBREVIATIONS**

AAA	American Accounting Association
AICPA	American Institute of Certified Public Accountants
ASB	Accounting Standards Board
ASC	Accounting Standards Committee
CAF	Charities Aid Foundation
CARC	Charity Accounting Review Committee
CICA	Canadian Institute of Chartered Accountants
FASB	Financial Accounting Standards Board
GASB	Government Accounting Standards Board
ICAS	The Institute of Chartered Accountants of Scotland
NFPO	Not-for-profit Organisation
NPPI	Non-profit Performance Indicators
SORP	Statement of Recommended Practice
UK	United Kingdom

# EXECUTIVE SUMMARY

## Background

The charity sector is large and growing, and has substantial assets at its disposal. Charities now form an increasingly important part of the UK economy, and their expanding role has increased the need for the charitable sector to formalise financial skills, expertise and standards of practice. While increased public prominence for many charitable organisations has changed public perceptions of the roles these organisations perform (Charities Aid Foundation (CAF), 1996), it is difficult to quantify the extent of their contribution to the social well-being of individuals or communities. However, the growth in the size and influence of the sector is clear, and this has led to increased visibility and public scrutiny by diverse stakeholders including government oversight agencies, private donors and foundations, clients, the media and the public at large.

The user-needs model is now well established as a useful basis for a conceptual framework for charity reporting, and the view that accounting should provide information to satisfy the information needs of users is inextricably linked with the concept of accountability. Members of a charity and other interested parties have information needs, yet because they are not involved in the management of the charity they must rely on the annual report to meet those needs. This is a major part of the process of discharging accountability by the charity to those outside its immediate management, as the information is important for making decisions and judgements relating to involvement with, and support of, the organisation. In considering the accountability of charities, two key questions emerge:

- To whom is a charity accountable?; and
- What form should that account take?

Annual reports and financial statements are recognised as key documents in the discharge of accountability to external users. Two main types of information that are particularly important in discharging accountability are:

- Financial information as contained in traditional financial statements;
- Wider performance information, often of a non-financial nature, relating to the goals, objectives, efficiency and effectiveness of the charity.

The main objectives of the research included in this publication are:

1. To review the importance of, and difficulties of using, performance information in charity external reports;
2. To examine previous research related to the accountability of charities and provide an overview of guidance connected to performance reporting that may be useful to charities;
3. To identify the current state of performance reporting by large UK fundraising<sup>1</sup> charities.

### **The importance of, and difficulties of using, performance information**

It is argued that while information disclosed in the financial statements may be of importance, other wider information, particularly relating to performance, is paramount in discharging accountability. Previous research by Hyndman (1990) provides backing for this viewpoint. If an organisation is viewed in terms of the usual production

model consisting of three stages (inputs, outputs and results/outcomes), two key criteria for judging performance are:

- **Effectiveness** – the relationship between the outputs or results of an organisation and its objectives. A measure of effectiveness for a charity could be the number of children fed *versus* the planned number, or the decrease in blindness in a particular area *versus* planned decrease;
- **Efficiency** – the ratio of outputs to inputs, or the amount of input per unit of output. An example of an efficiency measure for a charity might be the cost (an input) per child fed (an output), or the number of cases handled (an output) per employee (an input).

With both business enterprises and not-for-profit organisations (NFPOs) there is a consensus regarding the importance of performance information in meeting the information needs of a variety of users. However, a major difference between a charity, or any NFPO, and a business enterprise is that of entity purpose. A business has a profit objective while a charity does not. Anthony (1980) argues that in businesses both the inputs and the outputs can be measured in money terms. Furthermore, because the overall objective is profitability, then profitability, the difference between inputs (expenses) and outputs (revenues), is useful for evaluating efficiency and effectiveness. With charities there is no corresponding monetary measure of output and no profit objective. Therefore, the ‘profit’ figure does not have the same meaning, although it would seem perfectly reasonable for charities, or indeed any NFPO, to seek a small surplus to support future plans and provide a degree of flexibility (although reporting large surpluses may deter would-be donors). Given the reduced relevance of ‘profit’ or ‘surplus’, coupled with charities often having multiple, non-financial

objectives, it may be difficult to measure output and therefore difficult to evaluate performance.

Two key, and linked, reasons for measuring performance in a charity are:

- it can form the basis for discharging accountability (the focus of this research report); and
- it provides essential information to improve the organisation's management planning and control systems.

While the external reporting of performance information by charities can provide a visibility to the activities and achievements of the organisation thus enabling informed discussion on the part of users, it also provides a pressure on management to improve performance. A number of writers have suggested that where accountability for performance is weak, management might have limited incentive to manage an organisation's funds efficiently and effectively. While the thrust of this argument may ignore the very obvious commitment and professionalism of managers in the charity sector, it does provide a persuasive case for the development and use of comprehensive performance measurement and performance reporting systems by charities.

Notwithstanding the importance of performance measurement and performance reporting, many difficulties confront those tasked with developing an information system that provides such measures. These include:

- Setting clear goals and objectives;
- Avoiding a ritualistic approach where the process of setting objectives and reporting performance degenerates into a formal ceremony with little impact on behaviour;
- Ensuring that the information is reliable;
- Dealing with the complexity of organisations;
- Ensuring that quality, as well as quantity, is measured;

- Making meaningful comparisons between measures;
- Co-ordinating measures so that the low-level measures help to motivate individuals to behave in a way that furthers the overall strategic mission of the organisation.

Knowledge of these difficulties may help to focus attention on some of the important issues to be addressed by the system designer, and support the development of appropriate and well-balanced performance measurement systems. For example, an awareness of the differences between activities, outputs and results (or outcomes) is important with regard to the drafting of goals and objectives. It is perhaps tempting (and in some cases unavoidable) to define objectives in terms of activity rather than outputs or outcomes related to the strategic mission of the charity. The problem with this is that more activity is not necessarily a good thing, particularly in the case where more activity, and more expense, does not lead to more, or better outcomes. However, drafting objectives in terms of ultimate outcomes is also fraught with problems because of the often intangible nature of ‘outcome’, the time horizon over which it occurs and the impact which factors unrelated to the activity of the charity may have.

## **Previous research and related guidance**

While performance accountability is viewed as important, much of the earlier research on the accountability of charities has focused on financial accountability, where it is argued that the quality of financial statements can be judged in terms of their compliance with the extant Statement of Recommended Practice (SORP), or generally accepted accounting principles. Overall, these studies have shown that the impact of SORPs has been significant with large charities, somewhat limited in the case of small charities, and lagged (that is to say, if adopted, not immediately adopted) with most charities, regardless of size. Prior to the empirical research included in this research report, what research has

been done with regard to the performance accountability of charities, which was largely published in the early 1990s, has highlighted the importance of performance information to contributors to charities and the lack of disclosure of such information by charities. The research suggested a lack of accountability by charities and argued that more user-need driven reports would rectify this weakness and could possibly lead to the more effective and efficient operation of charities.

Within other research related to performance accountability in the wider not-for-profit sector, there is a clearly expressed recognition of the importance of such information, although many studies show that, generally, there is a lack of disclosure of performance information. However, one of the most striking exceptions to this is in the UK public sector. Research published in the late 1990s and related to performance measurement and performance accountability in this sector showed that, over time, performance reporting had improved. In particular, this improvement was evidenced by the inclusion in annual reports of more performance information, and an increasing emphasis being placed on what were termed the 'higher measures of performance' (that is efficiency and effectiveness). It was argued that such a pattern of reporting was possibly a function of the high-level commitment within government to performance reporting and the guidance provided to facilitate this, and it was suggested that an evolution of performance reporting in the public sector was underway. This has been viewed as beneficial in terms of accountability and in terms of developing more efficient and effective organisations.

With the exception of some limited CAF guidance (CAF 2001) in relation to their charities' annual accounts awards and the recommendations contained in the recent review of charities and the wider not-for-profit sector by government (Cabinet Office, 2002), there has been little or no other charity-specific guidance relating to measuring and reporting performance. By contrast, in the UK public sector, a diverse sector within which many organisations have similar

characteristics to charities, the importance of measuring and reporting performance has been articulated strongly, and a plethora of guidance, much of it that could be ‘read across’ to charities, has been provided. This guidance concerns itself with matters such as the attributes of performance measures and the design of performance information systems. Two examples of such guidance are reviewed in this research report:

- Executive Agencies: A Guide to Setting Targets and Measuring Performance (HM Treasury, 1992);
- Choosing the Right Fabric (a framework for performance information (HM Treasury, 2001).

Furthermore, details of other UK and international publications that can be accessed via the internet are provided in appendix two. While much of this guidance acknowledges that performance measurement is a difficult and complex task, and rarely, if ever, will there be a perfect measurement system, it promulgates the view that appropriately developed performance measurement and performance reporting systems can lead to more accountable organisations and support management in their planning and control functions.

## **Current practice**

The empirical study included in this research report sought to ascertain the extent to which performance accountability is discharged through the medium of the annual report. On the basis of an analysis of the annual reports of the top 100 UK fundraising charities over two accounting periods (1996/97 and 2001/02), the following findings and arguments are presented:

### There is extensive reporting of basic background information

It is argued that ‘basic background information’ (such as, for example: an indication of the governing instrument; details of how a charity is constituted; review of the year; and an explanation of the salient features of the accounts) is important to provide a context to understanding the performance of a charity. Both the CAF and the Charity Commission recommend the disclosure of such information. Seven items of basic background information were identified and reported, and with each item disclosure was extensive (at, or approaching, 100 per cent in each case) over the two reporting periods. This suggests that most users of the annual reports of large UK charities have access to basic background information that may be useful in providing a context to the understanding and interpretation of any performance information.

### There is an inadequate discharge of performance accountability

Although previous charity accounting research has indicated that performance information has high importance to users of charity accounts and is recognised as having importance to users by providers of information, it is not widely disclosed by charities. Even allowing for the fact that there are many difficulties experienced by charities as they seek to measure performance, the results suggest that extant charity reports do not meet the most important information needs of users and therefore the relevance of such reporting can be questioned. For example, a significant proportion of charities reported no information on effectiveness and efficiency, the two key criteria for judging performance. With regard to the 2001/02 annual reports, 91 per cent of charities did not disclose a single measure of efficiency. Similarly, 71 per cent did not disclose a single measure of effectiveness. Given the importance to users of efficiency and effectiveness information,

a lack of publication suggests a charity sector where accountability for performance is not discharged in an adequate manner. Moreover, it is argued that such a lack of publication may disadvantage good performing charities. The disclosure of performance information, in cases where a charity has operated efficiently and effectively, may well increase its attraction to potential contributors.

### There has been some limited improvement in performance reporting over time

Notwithstanding the above, there is some limited evidence of increased use of performance reporting by charities between 1990 and 1996/97, but no evidence of significant change since then. A comparison of this research with earlier research by Hyndman (1990) provides some limited insights into how performance reporting by charities has changed over time. Of five of the eight performance-related items analysed in this study that were also analysed in the earlier Hyndman study, average disclosure increased from 19 to 47 per cent by 1996/97. Greater reporting of goals and objectives, and outputs was particularly noticeable. However, there was a clear reduction in the percentage of charities disclosing efficiency information, one of the most important information types sought by users, perhaps indicating the increasing sensitivity of charities to publishing such information. Possible explanations for the general improvement in reporting may have been:

- The increasing articulation of the importance of performance reporting by such organisations as the CAF, evidenced by their promotion of the *Charities Published Accounts Awards* and the related guidance provided (CAF, 2001)<sup>2</sup>;
- The influence of practices in the public sector, where performance-reporting systems have developed more strongly.

Average levels of disclosure of the eight items of performance information reduced slightly between 1996/97 and 2001/02 (from 60 per cent to 53 per cent), mainly caused by the decreasing publication of effectiveness information, again one of the most important information types sought by users. In this case, it appeared that there was a tendency to reduce the reporting of specific effectiveness information in the 2001/02 reports and increase the reporting of more 'marketing-focused' information. Indeed, in a number of matched cases, the annual reports of charities in 2001/02 were much glossier productions, replete with many photographs but contained fewer measures of effectiveness.

### Compared with the UK public sector, performance reporting is poor

Generally, in terms of the wider not-for-profit sector, the lack of disclosure of performance information is pervasive. However, it is interesting to note that this is not the case in the UK public sector, where many organisations display similar characteristics to charities and would appear to have comparable difficulties in measuring performance. In this sector, where there has been clear articulation from high levels in government of the need to develop appropriate performance measurement systems, the measuring and reporting of performance has improved significantly over time. This has been viewed as beneficial, both in terms of accountability and in terms of improving management within the sector. Given these developments, which have been encouraged by a proactive central support function, greater prescription and specific public sector guidance, the change in charity reporting is perhaps disappointing. While some effort has been made to highlight the need for charities to disclose more performance information, the concentration on specific guidance has been on financial accounting matters and this may have detracted

from a meaningful debate relating to the relevance of the information content of charity annual reports.

### There may be a lack of willingness to disclose performance information

From previous research, it is clear that providers of charity information are largely aware of the information needs of users of charity reports but, as is seen in this research, do not disclose. The research included in this report does not identify the reasons for this, but among possible explanations are: charities may be satisfied with existing reporting procedures; they may fear that some performance information may be misinterpreted; or they may take the view that the cost of providing such information is disproportionately high compared to the benefit received (indeed, it could be argued that a lack of disclosure is indicative of an efficient charity). Nevertheless, there may be economic incentives, as there are with businesses, for such voluntary disclosure. Disregarding accountability issues, it could be argued that in an environment where charities compete for contributions, the voluntary disclosure of performance information, possibly emphasising past performance and future plans, may enhance its attractiveness to existing and potential donors. Furthermore, in terms of the internal management of a charity, a weak regime of performance reporting externally may be indicative of a lack of availability of performance information to managers, suggesting poor planning and control within the charity. In a related argument, it has been suggested by some writers that managers in both public and private organisations may prefer limited performance reporting because they seek to avoid accountability.

## The scope for window dressing may have impacted on performance reporting

Although the case for some degree of independent verification of performance information included in external reports appears strong, the performance information identified in this study was not subject to verification (as is the case with performance disclosures in most NFPOs). This scenario introduces the temptation for ‘gaming’ on behalf of the information provider. For example, as Beattie and Jones (1994) have argued, charities may, by a liberal policy of expenditure classification, attempt to minimise administration expenses in comparison with their charitable expenditures. The reducing scope to engage in such behaviour, with much greater prescription regarding expenditure classification in the more recent SORPs, may have impacted on the extent to which efficiency measures were disclosed (disclosure reduced from 21 per cent in 1990 to 9 per cent in 2001/02). Efficiency measures, particularly those relating administration costs to total costs, are often perceived as potentially damaging headline figures. Overall, with regard to performance information, if no verification of the performance numbers reported by a charity is required, then there may be a temptation to present performance in a manner that is perceived as more acceptable to the reader, for example by exaggerating good performance, regardless of its accuracy. Although, here again, cost/benefit issues need to be considered, given that external parties may use externally reported performance information to make judgements and decisions regarding a charity, then there appears to be a case for some degree of independent verification. While this issue has been discussed in the context of the public sector organisations with a suggestion being made that UK public sector organisations should aim to achieve ‘independent validation’ of performance information, there has been no significant debate regarding this issue in the charity sector.

## The future

This research report contributes to the debate on the accountability of charities. It argues that well developed and appropriate performance measurement and performance reporting systems can help to discharge an important aspect of accountability. While accepting that there are substantial difficulties in measuring performance (even strong supporters of performance measurement systems realise that performance is often a contestable notion and cannot be measured perfectly), an awareness of these difficulties and an understanding of their potential impact can help the system designer. With an investment of time, effort and expertise in such a project, and a sensitive and intelligent approach, a system should emerge that can contribute to the discharge of accountability by, and the improvement of management within, charities.

The charity sector in the UK has grown significantly, is continuing to grow, and has a major economic and social impact. To maintain confidence in the movement, improvements in accountability, and in particular with regard to performance accountability, would seem essential. Indeed, such improvements could be viewed as a necessary condition for further growth of the sector. However, without the provision and promotion of specific charity-focused guidance, possibly provided and promoted by those concerned with the administration and control of the charity sector in the UK, it is likely that the present limited state of performance reporting by charities will continue. Organisations that may be expected to have an interest in facilitating such provision include the Charity Commission in England and Wales, the CAF and the Scottish Charities Office. Indeed, the bones of such guidance could be 'read-across' from that existing in the UK public sector. Interestingly, the recent performance reporting recommendations included in the review of charities and the wider not-for-profit sector by government (Cabinet Office, 2002), promulgated a number of high principles regarding the measurement

and reporting of performance, and may prove to be a necessary catalyst to begin a process of changing the focus of charity reporting. With government as a ‘champion of change’, change may occur. Overall, if the annual reports of charities are to meet the information needs of users, guidance and support would seem essential. Given charities’ expertise, focus and limited resource base, to expect individual charities to develop meaningful and extensive performance reporting systems without such guidance is perhaps optimistic.

## Endnotes

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1. Fundraising charities are income-generating registered charities that the general public would recognise as the charitable sector. They can be contrasted with grantmaking trusts, which are charities that make grants from an endowment. Generally, the largest fundraising charities are larger than the largest grantmaking trusts. The majority of fundraising charities also have a grantmaking role (Osborne and Hems, 1994) and a small number of the CAF’s largest fundraising charities appear in the CAF’s list of the 500 largest grantmaking trusts. However, the grantmaking functions of CAF’s 500 largest fundraising charities account for a very small proportion of their total expenditure. For details of the charities and amounts involved see CAF (2002).
2. It should be noted that the Scottish Council for Voluntary Organisations, in association with the ICAS and Brodies Solicitors, promoted a similar competition, and provided related guidance, for Scottish charities in the mid-1990s.

# CHAPTER ONE

## INTRODUCTION AND BACKGROUND

The purpose of this chapter is to provide a brief profile of the scope and size of the charity sector, introduce the concept of accountability and to outline the purpose and structure of the report.

### **The charity sector and its accountability**

The legal definition of a charity in the United Kingdom (UK) is less than clear, with the Charities Act (1960) stating that a charity is any institution that is established for ‘charitable purposes’. A major reference point in deciding whether a particular purpose is charitable or not is the preamble to the Elizabethan Statute of Charitable Uses (1601). This provided a list of objects that are considered to be charitable. Lord Macnaghten, in the case of *Income Tax Special Purposes Commissioners v Pemsel* (1891), classified these objects into four main groups as follows: the relief of poverty; the advancement of education; the advancement of religion; and other purposes to the community which the law recognises as charitable. To be recognised as a charity confers certain benefits, chiefly of a fiscal nature, on an organisation.

The charity sector in the UK comprises a vast and growing segment of economic activity. There were over 188,000 charities registered with the Charity Commission of England and Wales at the end of 2001, with an estimated annual income of £26.7 billion (Charity Commission, 2002). It is estimated that there are 31,432

charities in Scotland (Inland Revenue, 2003) and that there are approximately 5,000 charities in Northern Ireland (NI) (NI Council for Voluntary Action, 1998). This sector includes such well-known charities as Oxfam (income in 2001/02 £189 million), Barnardos (income in 2001/02 £106 million) and Macmillan Cancer Relief (income in 2001/02 £70 million). Many of these charities have formed vital partnerships with government in the provision of a wide range of services. Growth in the size and influence of the charity sector has led to increased visibility and public scrutiny by diverse stakeholders including government oversight agencies, private donors and foundations, clients, the media and the public at large.

Charities receive significant resources from resource providers who do not expect to receive either repayment or economic benefits proportionate to resources provided, they have operating purposes other than to make a profit, and they have no defined ownership interest that can be sold, transferred or redeemed. These are key characteristics of any not-for-profit-organisation (NFPO) (Financial Accounting Standards Board (FASB), 1980a). Given these characteristics, an obvious question relates to their accountability, particularly to the resource providers. Accountability has been defined as 'being obliged to explain one's actions, to justify what has been done' (Government Accounting Standards Board (GASB), 1987, p.21). Discussions of this concept in the context of NFPOs have been commonplace in the last decade (Likierman and Creasey, 1985), and this is an important issue for charities. To whom is a charity accountable, and what form should that account take?

A charity's trustees are responsible for the preparation of the annual report and financial statements, which, together, are generally recognised as key documents in the discharge of accountability to external users. *The Corporate Report* (Accounting Standards Committee (ASC), 1975) states that such information packages are (p.16) 'the primary means by which the management of an entity is able to fulfil

its reporting responsibility'. The introduction to the 2000 Statement of Recommended Practice (SORP) (Charity Commission, 2000) states that the purpose of preparing a charity's annual report and financial statements is to discharge the trustees' duty of public accountability and stewardship. It is suggested that, among other things, the annual report and financial statements should enable the reader to understand the charity's structure, activities and achievements. To this end, the 2000 SORP recommends that the trustees' report includes certain legal and administrative information, for example, an indication of the charity's governing instrument, details of how the charity is constituted, a review of the year and an explanation of the salient features of the financial statements.

Recent research relating to charity external reporting has concentrated on the form and content of the financial statements (income statement/statement of financial activities, balance sheet, cash flow and notes) with the major thrust of the findings being that external financial reporting by charities is characterised by a diversity of accounting practices and a lack of standardisation which has resulted in difficulties for users in understanding financial statements (Ashford, 1989; Gambling, Jones, Kunz and Pendlebury, 1990; Hines and Jones, 1992; Williams and Palmer, 1998; Connolly and Hyndman, 2000 and 2001). While weaknesses in financial statements are seen as problematical in terms of discharging accountability, research relating to UK charities, published over a decade ago (Hyndman, 1990), highlighted that although traditional financial accounting information dominated reporting by charities, performance information was viewed as more useful in terms of discharging accountability. In a related study, Hyndman (1991), it was found that providers of information were aware that performance information was of paramount importance to users of charity reports.

## Research objectives and approach

The main objectives of this research are:

- To review the importance of, and difficulties of using, performance information in the external reports of charities;
- To examine previous research related to the accountability of charities and provide an overview of guidance connected to performance reporting that may be useful to charities; and
- To conduct an empirical analysis of the annual reports of the top 100 UK fundraising<sup>1</sup> charities in order to ascertain the extent to which basic background information, and more specific performance information, is used in external reporting (in other words, this objective seeks to identify the current state of performance reporting by large UK charities).

Chapter two focuses on the first objective. The concept of accountability is examined in the context of NFPOs generally, and charities in particular. Performance accountability is contrasted with financial accountability, and the importance of charities measuring and reporting performance is emphasised. The chapter also discusses the meaning of performance with regard to charities, and considers the difficulties of measuring the performance of a charity. Chapter three deals with the second objective. It reviews briefly the fairly extensive previous research on the financial accountability of charities, as well as the more limited work focusing on performance reporting by charities. In addition, it provides a summary of related performance accountability research in the wider not-for-profit sector and reviews guidance regarding approaches to designing performance information systems. The fourth chapter centres on the last objective, which is the identification of the current state of performance reporting in large UK charities. An empirical analysis of performance reporting by the top 100 fundraising charities in the UK is presented. Performance reporting

is analysed over two accounting periods, and compared with earlier research, in order to gain some appreciation of changes over time.

The report is structured as follows:

Chapter two reviews accountability in terms of NFPOs generally, and charities in particular. The meaning of performance in the context of a charity, various classification systems for measuring performance, differences between performance measurement in a business and a charity, and the link between performance and accountability are all explored. Various levels (or types) of accountability are examined, and the need for the discharge of accountability for performance highlighted. In addition, the difficulties of measuring performance in the charity sector are explored, and it is suggested that an awareness of these difficulties may help in the design of appropriate and well-balanced performance measurement systems.

Chapter three reviews previous research related to the accountability of charities and provides an overview of guidance connected to performance reporting that may be useful to charities. Earlier research specifically focusing on the financial accountability of charities is briefly reviewed, while the rather limited research relating to charity performance measurement and performance accountability is presented in greater depth. In addition, similar research in the wider not-for-profit sector is examined. Finally, guidance linked to the development of performance measurement and performance reporting systems in NFPOs is reviewed, including the performance reporting recommendations contained in a recent review of charities by government. Overall, this chapter provides a context in which to understand the empirical work presented later in chapter four.

Chapter four outlines the method used in the empirical analysis of the annual reports of the top 100 UK fundraising charities. This analysis seeks to identify the current state of performance reporting by large UK charities. The extent to which basic background information and more specific performance information is used in

external reporting is determined. Basic background information can be viewed as being important in providing an appropriate context for the understanding of the performance of a charity. In addition, the research attempts to explore whether the extent of reporting of basic background information and performance information has improved in recent years, where improvement is seen in terms of increasing levels of disclosure. Results are presented, followed by an analysis and discussion of their significance.

Chapter five details the main conclusions of the research and identifies areas for further research.

## Endnote

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- <sup>1</sup> Fundraising charities are income-generating registered charities that the general public would recognise as the charitable sector. They can be contrasted with grantmaking trusts, which are charities that make grants from an endowment. Generally, the largest fundraising charities are larger than the largest grantmaking trusts. The majority of fundraising charities also have a grantmaking role (Osborne and Hems, 1994) and a small number of the CAF's largest fundraising charities appear in the CAF's list of the 500 largest grantmaking trusts. However, the grantmaking functions of CAF's 500 largest fundraising charities account for a very small proportion of their total expenditure. For details of the charities and amounts involved, see CAF (2002).

## CHAPTER TWO

# ACCOUNTING, ACCOUNTABILITY AND PERFORMANCE INFORMATION

This chapter reviews the concept of accountability in the context of NFPOs generally, and charities in particular. The meaning of performance in relation to charities, various classification systems for measuring performance, differences between performance measurement in a business and a charity, and the link between performance and accountability are all explored. Financial accountability is contrasted with performance accountability, and it is suggested that well-structured charity annual reports can provide a valuable medium through which performance accountability is discharged by charities. In addition, some of the difficulties of measuring performance in the charity sector are examined, and it is suggested that an awareness of these difficulties may help in the design of appropriate and well-balanced performance measurement systems.

### **User-needs, accounting and accountability**

Charities can be viewed as a subset of a much larger NFPO sector. Such a sector includes primarily service organisations and, in addition to charities, examples include government organisations, credit unions, universities, trade unions and political parties. As outlined in chapter one, although a neat definition of what constitutes a charity is problematical, charities are NFPOs (which, by definition, do not have

a profit motive), organised for any purpose that the law recognises as 'charitable', directed at fulfilling human and social needs.

The conventional view of accounting is that it is a purposive activity, directed towards a specified end, that is the meeting of users' information needs (for example, American Accounting Association (AAA), 1966; Canadian Institute of Chartered Accountants (CICA), 1980a; Macve, 1981; and Accounting Standards Board (ASB), 1999). While the main focus of these publications has been on business accounting issues, they have helped stimulate debate on user needs with regard to NFPOs. The user-needs emphasis was evident in the Trueblood Report (American Institute of Certified Public Accountants (AICPA), 1973) and the Statement of Financial Accounting Concepts No.4 *Objectives of Financial Reporting by Non-business Organisations* (FASB, 1980a) in the United States. Similar themes occur in discussions on a conceptual framework for financial reporting in the public sector (Jones, 1992; Lapsley, 1992; Mayston, 1992). These writings focus on issues such as the objectives of financial reporting and the information rights and needs of users. Summarising some of their main ideas, Mayston (p.228) states that:

*As a normative objective for financial reporting, the meeting of users' needs has now been widely accepted as the central objective by a long series of reports on the objectives of financial reporting in the private sector ... and in the public sector.*

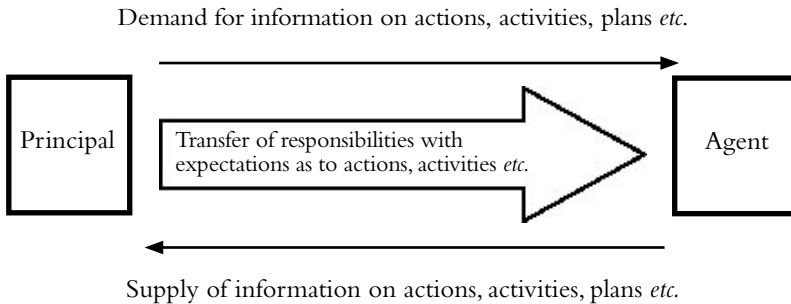
This theme was also central in the work of Bird and Morgan-Jones (1981), a research report that ultimately led to the publication of SORP 2 *Accounting by Charities* (ASC, 1988), which was subsequently revised in 1995 (Charity Accounting Review Committee (CARC), 1995) and in 2000 (Charity Commission, 2000). These publications sought to reduce the diversity of accounting practice in charities' published financial statements on the basis that a lack of consistency

makes it difficult for users of accounts to understand (and therefore use) the information provided.

While accepting the argument made by Jones and Pendlebury (1996) that accountability, in its widest sense, is more than accounting (however widely accounting is defined), focusing on the information needs of users (a key aspect of a contemporary definition of accounting) seems clearly linked with ideas relating to accountability. A dictionary definition of accountability views it as being 'responsible to someone or for some action' (HarperCollins, 1993). Jackson (1982, p.220) defines accountability in terms of 'explaining or justifying what has been done, what is being done and what has been planned'. Rutherford (1983) views accountability as being related to the requirement to be answerable for one's conduct and responsibilities. Edwards and Hulme (1995), when discussing non-government organisations and 'grassroots' organisations, see accountability as a means by which individuals and organisations report to a recognised authority and are held responsible for their actions. In an organisational context, these definitions might imply responsibility to an oversight agency (for example, the Charity Commission) with formal record keeping and reporting requirements as a means of demonstrating compliance, and explicit standards of performance or assessment by this higher authority. This accountability relationship (or user-needs model) can be summarised in Figure 2.1, which is an adaptation of Laughlin's (1990) skeletal model. The principal transfers to an agent resources and expectations regarding the transfer. These expectations form the basis of the accountability

relationship. As Laughlin highlights, these expectations are complex and may be written and explicit, or unwritten and implicit.

**Figure 2.1** *Accountability Relationship*



The previous discussion of accounting and accountability highlights the importance of the users of the information. A logical progression from this position would be that a consideration of the information needs of users is necessary prior to the determination of the information that will be provided by the reporting entity. With regard to public sector organisations, part of the wider NFPO sector, the GASB (1987) highlight three groups as primary users of accounting reports: the citizenry, legislative and oversight bodies, and investors and creditors. Similarly, with regard to NFPOs generally, the CICA (1980b) specify a range of users: grantors, donors and members; governments; directors and operational management; business; recipients of goods and services; employees; and society at large. Comparable lists have been provided by other writers (AICPA, 1973; Skousen, Smith and Woodfield, 1975; Anthony, 1978; FASB, 1980a; CICA, 1984). An examination of these highlights a common position where it is accepted that there is a need to report to those outside the immediate management of a NFPO. In particular, the FASB (1980a) and Hyndman (1990) argued that, of all the user groups, resource providers are the most obvious

and important. Similarly, Reynolds (1981, p.69), when considering information disclosure by health and welfare organisations, argued that resource providers are the primary supporters of NFPOs and therefore 'they may be considered the primary external user of the organisation's information'. Specifically with regard to charities, Hyndman (1991), in a survey of 246 information providers, found the perception amongst charity managers and auditors of charity financial statements that the annual report of a charity should primarily be directed towards meeting contributors' information needs.

Contributors have no easily exercised right to demand information (although some individual contributors, because of the size of their contributions, may be able to make such demands) and must primarily rely on charity annual reports. The position of this group is akin to the users with which *The Corporate Report* (ASC, 1975, p.9) was concerned when it stated:

*The users with whom we are concerned are not those possessing special authority (managerial, proprietorial or statutory) to demand particular information at their discretion whenever they require it, but that larger class of general users to whom a responsibility to report is owed and who are not in a privileged position to enforce special demands.*

Annual reports are generally recognised as key documents in the discharge of accountability to external users (Taylor and Rosair, 2000; Coy, Fischer and Gordon, 2001), and are widely used by many NFPOs, including charities, although their ability to engage with users in some contexts has been questioned (Jones, 1992; Priest, Ng and Dolley, 1999). *The Corporate Report* (ASC, 1975, p.16) stated that such information packages are 'the primary means by which the management of an entity is able to fulfil its reporting responsibility'. It is interesting to note that a recent UK government report (HM Government, 2001), when attempting to gauge the accountability of non-governmental public

bodies, used the publication of annual reports as the first criterion in judging the discharge of accountability. In relation to charities, the introduction to the 2000 SORP (Charity Commission, 2000) states that the purpose of preparing a charity's annual report and financial statements is to discharge the trustees' duty of public accountability and stewardship. It is suggested that, among other things, the annual report and financial statements should enable the reader to understand the charity's structure, activities and achievements.

The concept of accountability is multifaceted. This is reflected in the fact that there may be various bases of accountability, which may have differing degrees of importance to different user groups, and indeed individual users within the same user group. A number of writers have attempted to explore this intricate concept in a variety of ways (Stewart, 1984; Gray and Jenkins, 1985 and 1992; Kearns, 1994; Rubin, 1996; Taylor and Rosair, 2000). Stewart (p.16) states that:

*Within any field of accountability the bases of accountability must be defined. In relation to the activities for which accounts have to be given, the purpose of the account and hence the basis of accountability can vary.*

He then goes on to develop a 'ladder of accountability', relating to public accountability, which contains the following 'rungs': accountability for probity and legality; process accountability; performance accountability; programme accountability; and policy accountability. For example, accountability for probity and legality is related to the avoidance of malfeasance, ensuring that funds are used properly and in the manner authorised, and that the powers given by the law are not exceeded. By contrast, performance accountability is concerned with ensuring that there is no waste in the use of resources (efficiency) and, in a wider sense of performance, whether performance achieved meets required standards.

There are no standardised definitions for the types of accountability highlighted in Stewart's (1984) ladder, and indeed it is possible to contend that there are overlaps. However, the analysis highlighted that the information requirements vary with the differing bases of accountability. It is argued that as you move up the ladder, you move from accountability by standards (emphasising accountability for probity and legality) to accountability by judgement (with policy accountability). This makes the identification of the information needed for the discharge of accountability difficult. In the case of external reporting by public sector organisations, Hyndman and Anderson (1998, p.24) stated that the information needs of the various user groups may well be different and suggested that:

*... the citizenry may be most interested in the results, or effectiveness, of an organisation, while the concern of oversight and legislative bodies may be jointly focused on wider performance information, including efficiency, and probity. Investors and creditors may be primarily interested in financial information relating to solvency. In a similar vein, for those groups (including management) with an interest in performance information the measures which are crucial for one group may be significantly less important to another group.*

Overall, Stewart argues that an accountability information system should report on all levels of accountability, providing financial information and also output and outcome information.

In a similar vein, Kearns (1994), when discussing NFPOs in the United States, suggests that a system of accountability contains at least two dimensions: a set of performance standards (explicit or implicit) generated by the NFPO's strategic environment; and a response (reactive or proactive) from inside the NFPO. Explicit standards are those generally codified in law, administrative regulations or contractual obligations. Implicit standards involve general notions of acceptable administrative action and organisational behaviour as defined by societal

values, beliefs and assumptions. Kearns developed a matrix with four distinct, yet inter-related, dimensions of accountability as follows: negotiated accountability; compliance accountability; professional/discretionary accountability; and anticipatory/positioning accountability. While a detailed discussion of these various types of accountability, and of the various rungs in Stewart's (1984) ladder, is beyond the scope of this research report, what is suggested by both writers is that with some types of accountability (for example, accountability for probity and legality, and compliance accountability) one can have accountability by standards, whilst with higher levels of accountability (for example, with policy accountability and anticipatory/positioning accountability) accountability by judgement is required.

While the definitions and explorations of accountability presented above contain useful elements and illustrate the multifaceted nature of the term, they also provide some suggestion that accountability in NFPOs is complex and problematical. For example, even though the GASB (1987), in its *Concepts Statement No 1*, views accountability as the 'paramount objective' in financial reporting, it acknowledges that the term suffers from imprecise meaning. Similarly, Edwards and Hulme (1995, p.9) suggest that accountability 'is a complex and abstract concept', while Patton (1992, p.166), in a detailed discussion of accountability, concurs with this:

*In most settings one party (individual, group, company, government, organisation, etc.) is said to be directly or indirectly 'accountable' to another party for some thing, action, process, or outcome. However, the precise meaning and implication of the concept of accountability are often left unclear.*

This lack of specific clarity can be seen in that operational definitions of accountability often focus on narrow and technical issues of compliance with specific legal mandates, such as the filing of accounts in a specified format, while conceptual definitions tend to

become overly complicated, even ambiguous, in an attempt to meet the often shifting, and perhaps even conflicting, needs of diverse users (Stewart, 1984, Rubin, 1996; Taylor and Rosair, 2000). This view is supported by the fact that discussions of accountability in the context of NFPOs have focused on such disparate issues as: measuring the value-added performance of NFPOs in terms of actual outcomes and impacts (Kanter and Summers, 1987; Drucker, 1990); clear disclosure of fund raising and executive compensation practices (Hills Bush, 1992; Kahn, 1992); and fulfilling obligations associated with tax exemptions (Ackerman, 1982; Simon, 1987).

In a similar manner, the application of a user-needs model presents challenges. The identification of legitimate stakeholders, their prioritisation and their information needs are obvious areas where difficulties may arise. Edwards and Hulme (1995) have highlighted the problem of multiple accountabilities, and the possibility of 'over accounting' because of multiple demands, or 'under accounting' as each user assumes that another user is taking a close look at actions and results. They suggest that many of the concerns expressed about weak accountability relate to the difficulties in prioritising and reconciling multiple accountabilities. Similar issues are discussed by Likierman and Creasey (1985). They suggest that caution needs to be exercised when attempting to apply the user-needs model because of, among other things: the imperative to set out the basis for any assertion about needs or rights; the resolution of conflicts that arise when attempting to fulfil such requirements; and the lack of clarity in some of the statements of reporting objectives. In a related vein, Rutherford (1983, p.22) concludes that although user-needs models provide interesting insights they 'do not yield very rigorous prescriptions for the information to be provided'. Similarly, Taylor (1989) identifies a number of weaknesses of the user-needs model as applied to the NFPO sector, where it is argued that many users' decisions are based more on non-accounting rather than accounting information.

## Performance: key concepts

### Performance defined

In the case of NFPOs, it is not uncommon to view performance in terms of a production model, with performance being judged in terms of efficiency and effectiveness. Details of four simple production models of the operation of an NFPO are presented in Figure 2.2.

**Figure 2.2 Production Models of the Operation of a Not-for-profit Organisation**

<b>Brace et al.<sup>a</sup> (1980)</b>	<b>AAA<sup>b</sup> (1989)</b>	<b>Carter et al.<sup>c</sup> (1992)</b>	<b>HM Treasury<sup>d</sup> (2001)</b>
Input	Cost and Input	Input	Inputs
Process		Process	
Output	Ouput	Output	Outputs
Result	Outcome	Outcome	Outcome

<sup>a</sup> Brace, Elkin, Robinson and Steinberg (1980), pp.5-7.

<sup>b</sup> AAA (1989), p.12.

<sup>c</sup> Carter, Klein and Day (1992), p.36.

<sup>d</sup> HM Treasury (2001), p.8.

While there are no standardised definitions for the terms inputs, outputs, processes and results (or outcomes), the following explanation may aid understanding. Inputs are the resources used in providing a service (*eg* expenditure incurred, number of staff). Processes represent the activities carried on by an organisation (*eg* number of visits made, number of cancer research projects funded). Outputs are the actual goods or services produced for consumption (*eg* number of children

fed, number of cancer research projects completed). Results (or sometimes referred to as outcomes) are concerned with the impact upon clients or situations (*eg* change in the level of education, overall level of satisfaction with the services provided). While these four stages of the 'production process' are represented as being distinct, in reality there may be some blurring at the edges. Difficulties, for example, may arise in distinguishing between an output and an outcome in certain circumstances.

Given this production model, Anthony and Young (1999), among others, argue that the two key criteria for judging performance are efficiency (the ratio of outputs to inputs, *eg* expenses, or the amount of output per unit of input) and effectiveness (the relationship between an organisation's outputs, or results, and its objectives). An example of an efficiency measure for a charity might be the cost (an input) per child fed (an output), or the number of cases handled (an output) per employee (an input). A measure of effectiveness could be the number of children fed *versus* the planned number, or the decrease in blindness in a particular area *versus* planned decrease. Often these criteria are used in a comparative, rather than an absolute sense. For example, it is not normally said that an organisation is 85 per cent efficient, but rather that it is more (or less) efficient than a comparable organisation, or that it is more (or less) efficient than it was last year, or that it is more (or less) efficient than budgeted for.

Other writers, while including efficiency and effectiveness as important aspects of performance, add other criteria. Economy is often added to complete what is commonly referred to as the 'three Es'. Efficacy (Flynn, Gray, Jenkins and Rutherford, 1988) and equity (Pollitt, 1986) add to criteria commencing with 'E', and acceptability and availability have been suggested by Clarke (1984). This list could be lengthened. Notwithstanding the merits of these additional criteria, efficiency and effectiveness are the dominant terms used in discussions on performance, both in businesses and in NFPOs.

With both business enterprises and NFPOs there is a consensus regarding the importance of performance information in meeting the information needs of a variety of users (ASC, 1975; FASB, 1980a; The Institute of Chartered Accountants of Scotland (ICAS), 1988). However, a major difference between a charity, or any NFPO, and a business enterprise is that of entity purpose. A business has a profit objective while a charity does not. It is argued by Anthony (1980) that in businesses both the inputs and the outputs can be measured in money terms. Furthermore, because the overall objective is profitability, then profitability, the difference between inputs (expenses) and outputs (revenues), is useful for evaluating efficiency and effectiveness. With charities there is no corresponding monetary measure of output and no profit objective. Although the 'profit' figure does not have the same meaning with a charity, it would seem perfectly reasonable for charities to seek a small surplus to support future plans and provide a degree of flexibility (although reporting large surpluses may deter would-be donors). With less focus on 'profit' or 'surplus', coupled with charities often having multiple, non-financial objectives, it may be difficult to measure output and therefore difficult to evaluate performance.

This is not to say that profit is a perfect measure of performance in a business organisation, or that non-financial measures are unimportant. Monetary measures do not cover all aspect of inputs and outputs. Profit figures are capable of manipulation and focus on the short run. Businesses may have wider objectives than merely profit. Non-financial issues such as customer satisfaction and quality may be important, and these could be key determinants of long-term success. For example, in their *Balanced Scorecard*, Kaplan and Norton (1996) promulgate the importance of non-financial measures to support long-term profitability objectives. However, it is likely that profit measures will be important in the evaluation of success, especially in the short term. Stewart and Walsh (1994, p.46) argue, when commenting on business organisations, that 'it is profit that is the final output ... there

are universally accepted, abstract, performance measures, such as return on capital, available'. By contrast, they argue that in public sector organisations, as is the case in any NFPO, the relevance of 'profit' or 'surplus' is different and (p.46) 'such simple, unequivocal measures are neither available nor appropriate'.

### Performance information and accountability

Two key reasons advanced for measuring performance in a charity are, firstly, that it provides essential information to improve management planning and control systems within the organisation and, secondly, that it can form the basis for discharging accountability by the charity. This research report, and in particular the empirical analysis reported in chapter four, focuses on the second of these objectives. However, the link between improving the planning and control system within a charity, and the discharge of accountability by a charity is important.

While an in-depth discussion of the use of performance measures and performance targets in planning and control systems of charities is beyond the scope of this research report (for a detailed analysis of the use of performance measurement in public sector planning systems see Hyndman and Eden, 2001), an outline of some of the key issues will provide insight. The importance and potential roles in establishing performance targets in operating a system of planning and control in a NFPO are emphasised by Anthony and Young (1999). They describe a statement of targets (or objectives) as (p.356) 'a key element in the management control system in a non-profit organisation' and argue that effectiveness can be measured only if actual outputs are related to targets. This idea is supported and developed by Mayston (1985) in considering the possible contribution of non-profit performance indicators (NPPIs) in the public sector. Among the potential roles highlighted by Mayston for NPPIs are: to clarify the organisation's objectives; to evaluate the final outcomes; to indicate performance standards; to indicate the

effectiveness with which different service activities contribute to each of the dimensions of achievement; to trigger further investigation and possible remedial action; and to indicate areas of potential cost savings. Each of these roles can provide support for the planning and control system of a charity, and provide the basis for management to improve the efficiency and effectiveness of the charity.

The possible linkages between the use of performance information in the planning and control system of a charity and the discharge of performance accountability by a charity are unmistakable. While a focus on performance measures and performance targets in planning and control systems of charities would stress the importance of objectives and targets in supporting management as they make decisions, such objectives and targets could also provide a platform for the discharge of performance accountability by charities. Hyndman and Anderson (1997, p.46), in reviewing the use of performance information in external reporting and internal planning in the public sector, argue that ‘a well developed set of objectives and targets can provide a valuable basis for the discharge of accountability’. Similar comments can be made in the case of charities, suggesting that a clearly articulated and performance-focused planning and control framework would facilitate the discharge of accountability.

Specifically with regard to accountability, the previous discussion in this chapter on user-needs, accounting and accountability highlights a number of different types (or levels) of accountability. Edwards and Hulme (1995, p.9) argue that effective accountability requires:

*... a statement of goals (whether in adherence to certain rules or achievement of identified performance levels), transparency of decision making and relationships, honest reporting of what resources have been used and what has been achieved, an appraisal process for the overseeing authority(ies) to judge whether results are satisfactory and concrete mechanisms for holding to account (ie, rewarding or penalising) those responsible for performance.*

While accepting that there are other forms of accountability, Hyndman (1989), in attempting to develop a theoretical model for reporting to contributors to charities (which was later verified by empirical investigation, see Hyndman, 1991), argued that there were two main types of information required by contributors – performance information (which is the focus of this publication) and financial information as contained in traditional financial accounts (which is not the focus of this publication). Hyndman, McKillop, Ferguson and Wall (2001), when reviewing the information needs of members of credit unions, organisations that are also part of the wider not-for-profit sector, make a similar argument. They suggest that financial information, as contained in traditional financial statements, is of importance to members for reasons such as ascertaining liquidity and identifying whether or not the organisation has lived within its means. It is also argued that members need other information, particularly that relating to the performance of the credit union, because credit unions have goals and objectives that have wider social foci.

A number of writers (Gibson, 1978; Gray, 1983; Hedlund and Hamm, 1978; Hyndman, 1990) have argued that there may be a tendency to over-emphasise the discharge of accountability through traditional financial accounts at the expense of wider performance information. The importance of performance information in the discharge of accountability by public sector organisations is argued forcefully by Mayston (1985), Miah (1991) and Boyne and Law (1991), with the latter suggesting that in the absence of such information (p.179) ‘the concept of accountability and indeed the whole democratic process is simply a sham’. Gray (1984, p.84), when calling for more disclosure of performance information by charities, argued that ‘financial accounts can provide useful additional information. However, the financial accounts can only play a subsidiary role’.

Hatry, Fountain, Sullivan and Kremer (1990, p.iii), in a research report funded by the GASB, promulgate similar views when stating:

*...the GASB believes that SEA (Service Efforts and Accomplishments) reporting will become a major element of governmental financial reporting, assisting in fulfilling government's duty to be publicly accountable and in enabling citizens, elected officials, and other users of financial reports to assess that accountability.*

With regard to the UK public sector, analogous sentiments are found in a raft of official government publications (HM Treasury, 1992; Next Steps Team, 1995; Cabinet Office, 2000; HM Government, 2000), and in the *Modernising Government* (HM Government, 1999) White Paper. An argument is presented that performance measures are vital in providing a basis for reporting to those outside the immediate management of a public sector organisation, an aspect of discharging accountability. For example, a report by the Comptroller and Auditor General (HM Government, 2000, p.2) argued that 'performance measurement and reporting are intrinsic to the whole process of public management, including planning, monitoring, evaluation and public accountability'.

The importance of disclosing performance information is widely recognised as at least part of the process of discharging accountability in charities, and indeed in all NFPOs. While traditional financial accounting may be important, in many cases wider performance information is paramount. In addition, while the external reporting of performance information by charities can provide a visibility to the activities and achievements of the organisation thus enabling informed discussion, it also provides a pressure on management to improve performance. With regard to the UK public sector, Eden and Hyndman (1999, p.13) suggest that 'while obfuscation of performance may suit some managers, the external pressure provided by the disclosure of performance information encourages a focus on performance and provides a catalyst for managers as they seek to achieve performance improvement'. Similar sentiments can be expressed in the case of charities.

Unless performance measures are in place, it is difficult for the charitable sector as a whole, or for individual charities in particular, to counter criticisms of poor management and ineffectiveness. Performance measures give a visibility to the resources, activities and achievements of a charity, thus enabling informed discussions and decisions. In addition, the need to discharge accountability encourages management to concentrate on the issues that are of importance to those stakeholders who are outside the immediate management of the organisation and often provide the resources for the organisation to function. Edwards and Hulme (1995, p.9) assert that the absence of accountability, and in particular performance accountability, 'begins to make the likelihood of ineffective or illegitimate actions by an organisation much more probable'. In the context of charities, this suggests that where accountability is weak, management might have limited incentive to manage the charity's funds efficiently and effectively.

### **Difficulties in measuring performance**

It has been argued that from both an accountability perspective, and from a basis of providing management with information necessary for them to plan and control the organisation, measuring the performance of a charity is essential. However, although this need is well founded, many difficulties confront those tasked with designing an information system that provides such information. A review of some of these difficulties may help to focus attention on a number of the key issues to be addressed by the system designer, and also provide the basis for a better understanding of the empirical work presented later in this research report.

## Setting goals and objectives

In any NFPO, the setting of goals and objectives is central to performance measurement. However, in many cases goals and objectives are so vaguely drafted that they hinder useful performance measures being developed. Williams (1985, p.3), in arguing that the drafting of objectives is the most crucial aspect of the performance measurement process, states that that 'I never cease to be amazed at how little thought is usually given to it'. Similarly, Carter (1989, p.134) observed that:

*There is great uncertainty in many service organisations because objectives are by no-means self-evident. Firstly, objectives are often absent, ambiguous or phrased in a very general, imprecise way. Second, organisations have multiple objectives.*

In charities, the drafting of goals and objectives can be crucial because without objectives a charity lacks direction. It is perhaps tempting (and in some cases unavoidable) to define objectives in terms of activity or process rather than outputs or results related to the strategic mission of the charity. The problem with this approach is that more activity is not necessarily a good thing, particularly in the case where more activity, and more expense, does not lead to more, or better results. It is vital to establish clearly the objectives of the charity. As far as possible, these should be specific, quantitative and time bounded (*ie* targets). This will facilitate performance measurement and ease of comparability.

## Avoiding a ritualistic approach

While setting objectives is critical to the development of a performance measurement system, there is a danger that defining goals and objectives, and setting targets and reporting performance against

them, will degenerate into a formal ceremony that has little impact on the behaviour of managers and does nothing to improve the efficiency, effectiveness and accountability of organisations. Thompson (1995) warned that unless care was taken in developing useful systems, there was a possibility of the whole exercise lapsing into a senseless ritual, which, sooner or later, would be abandoned as cost-ineffective. With regard to the public sector, this view is expressed even more strongly by Sharifi and Bovaird (1995, p.477):

*... it might ... be argued that in the public sector the potent **symbol** of performance orientation has helped to establish the **myth** that public sector organisations have a sense of direction and an explicable rationale for their actions. This myth is re-inforced by the **rituals** of performance measurement and reporting.*

### Reliability of the information

It has been argued in a number of influential publications (AAA, 1966; AICPA, 1973; ASC, 1975; ICAS, 1988; ASB, 1999) that accounting information should possess qualities such as relevance, objectivity, understandability, reliability and timeliness. Some of these characteristics pull in opposite directions and trade-offs are often required; for example, the price of improved relevance may be less objectivity, or the most reliable results may not be the timeliest. Because of this, accountants must exercise judgement in the selection of appropriate performance measures. An important issue relating to the publication of performance information, and one which is described by Pendlebury, Jones and Karbhari (1994, p.45) in the context of public sector organisations as 'the most significant technical problem', is that of the reliability of externally reported performance information. The reliability of a performance measure rests on the faithfulness with which it represents what it purports to represent and, in addition, the information (FASB, 1980b, p.x) 'must be verifiable and neutral'. For

this reason, Mayston (1985) has argued a case for bringing to bear similar disciplines on the external reporting of performance measures that are imposed on financial accounting information, *ie* disclosure requirements, external auditing and standard setting after consultation with interested parties.

It could be argued that if no verification of the performance numbers reported by a charity is required, then there may be a temptation to present performance in a manner which is perceived as more acceptable to the reader, for example by exaggerating good performance, regardless of its accuracy. Without some discipline and standardisation, management may engage in ‘gaming’, whereby they choose measures that show up the performance of a charity in a favourable light. This is especially the case when they have the power to change the measures from year to year. Although, as in many reporting choices by charities, cost/benefit issues need to be considered, given that external parties may use externally reported performance information to make judgements and decisions regarding a charity, then there appears to be a case for some degree of independent verification. It should be noted that the performance information analysed later in this study had not been subject to independent verification, as is the case with performance information reported by the vast majority of NFPOs. This issue has been discussed in the context of the public sector with a suggestion being made that UK public sector organisations should aim to achieve ‘independent validation’ of performance information (Public Accounts Committee, 1997, p.vii), although developments to date have been limited. A fuller discussion of the issue in a public sector context is contained in Likierman (1997). There has been no significant debate regarding this issue in the charity sector.

## Dealing with complexity

The idea that all charities should have goals, objectives, targets and performance measures, and have these linked in some sort of rational way as a basis for improving management, has been questioned. For example, Earl and Hopwood (1980) argue that in many organisations, especially those with high uncertainty about objectives and unclear cause and effect relationships (which may be typical circumstances for some charities), there is a need for less formal channels of information processing (including quantitative performance measures) and greater use of subjective judgement. In these cases there may be a danger of overemphasising quantitative measures and de-emphasising, or ignoring, the qualitative factors facing decision makers. Similar ideas are contained in Emmanuel and Otley's (1992) distinction between programmed and non-programmed decisions. While programmed decisions have a clear input–outcome relationship, non-programmed decisions are subject to uncertainty about their outcomes. In the latter case, greater subjective judgement and reliance on information other than that provided through formal channels is required. Earl and Hopwood (p.10) state:

*We do not seek to question the necessity for rationalisation machines, for organisations require mechanisms through which they can legitimise what is to be done and retrospectively create a rationale for action. What we do suggest is that the information processing which is typical of such procedures be recognised for what it is, and that more active acknowledgement be given to the fact that the creativity and inspiration, which are so necessary in such contexts, are more likely to spring out of socially interactive forms of information processing.*

This danger is also emphasised by Johnson and Scholes (1999, p. 54) who maintain that planning 'can become obsessed with the search for

absolute determinants of performance' and suggest the need to use a more flexible approach.

With regard to public sector organisations, a number of writers have highlighted difficulties. For example, Dearlove (1979, p.161) argued that the application of rational, co-ordinated systems of management in the public sector is often inappropriate because 'goals are complicated, muddled and ill-defined ...[and it] is a dangerous illusion to believe that a crisp and effective division of labour can be co-ordinated around the organisational objective'. In a similar vein, Gray and Jenkins (1986), suggest that although such systems display an attractive logic, they fail to cope with (p.179) 'the pathological uncertainty and disorder of public sector administration'. Also, Lapsley (1996) illustrates the difficulties of measuring performance in complex NFPOs by way of detailed analyses of performance measurement in public sector transport and health-care organisations. For example, after reviewing developments in performance measurement in the NHS over a period of approximately 20 years, he concludes that (p.126):

*... there remains the fundamental difficulty of (1) deriving global measures of health-care outcomes and (2) decomposing the constituent elements of such global measures in such a way that meaningful information is made available to all levels of management, in different kinds of organisations, which co-ordinates responses in pursuit of the global measure of improving health care.*

In the case of charities, and following these arguments, it may be that performance measures are useful in terms of providing a rationale, or legitimisation, of a charity's activities. However, there can be no 'one-size-fits-all' approach with all charities. For some charities, especially those that are complex, multifaceted and have unclear cause and effect relationships, too much focus on detailed objectives, performance targets and performance measures in the planning and control system, at the expense of wider qualitative factors, may be

inappropriate. In addition, the embracing of highly quantitative and co-ordinated performance systems by such charities may encourage production of too many unsuitable performance measures that are ultimately published in external reports as a means of providing an account of performance. Such a scenario can be confusing and unhelpful for users of such reports.

### Measuring quality

In all NFPOs, there is a danger that the quantity of output will be emphasised (how much) rather than the quality of output (how good). Quality can, in certain circumstances, be measured in terms of freedom from error. How many are correct? How many have passed? While there may be cases where quality may be measured in terms of ultimate results, often it will be viewed in terms of the outputs or processes of the organisation. Carter, Klein and Day (1992, p.177) argue that fairly low level measures of quality can be critical by suggesting that 'more often, the real indicators of quality will be that the ordinary, routine things are being done properly and on time'. However, with regard to higher-level measures of the quality of performance, which are usually more directly related to strategic issues, user surveys, professional judgement or peer-group review may be needed.

Overall, although the measurement of quality introduces an element of subjectivity, performance measurement systems that ignore it are likely to lack balance. In most cases quantity is easier to measure than quality, and hence there is a danger of the measurable displacing the unmeasurable (or at least the difficult to measure). This may lead to a distorted picture of performance being provided. Therefore it is important that the measurement system is constructed to identify quality differences in outputs and this information becomes an integral aspect of the reporting mechanism. Henley, Likierman, Perrin, Evans, Lapsley and Whiteaok (1992) argue that performance measurement

systems that do not address the question of quality may be misleading. They recommend that (p.286):

*Enough measures should be devised to give a well-rounded picture of performance ... Measures should not be used only because the measurement process is easier and in particular, adequate weight needs to be given to quality, which is almost always difficult to measure.*

### Joint costs and bases of comparison

Measures of performance are normally relative rather than absolute, and therefore some basis of comparison is needed. As Jackson and Palmer (1989, p.9) state, 'unless there is a valid basis of comparison or yardstick then the measure will be virtually meaningless'. As indicated previously, the most usual comparisons are: comparisons with previous years; comparisons with similar organisations; and comparisons of actual with target. To make these comparisons meaningful there is a need to match like with like wherever possible. When this is not possible it is important to interpret the measures in the light of any differences that exist. For example, where socio-economic variables are needed to interpret performance measures, as they may be in measures related to health or education, these should perhaps be provided together with an explanation of their potential significance.

A particular area of potential difficulty is with the allocation of joint costs, which is needed to derive financial measures of efficiency (eg cost per child fed, cost per operation conducted). The unscrambling of these joint costs, often on a fairly arbitrary basis, may make it difficult to compare measures between charities. To discourage inappropriate comparisons of efficiency it may be useful if, as far as is practicable, the method of allocating joint costs is disclosed. Furthermore, if comparisons over time are made of a particular organisation, then a consistent basis of allocation should be used. Possibly in an ideal world, some method of uniform costing for charities working in the

same area of activity would help inter-charity comparisons; although it is likely that such moves would be resisted because of the potential bad publicity of being a charity that showed up as being inefficient through such a process.

## Co-ordination

With regard to the public sector, formal guidance on setting targets and measuring performance resonates with the need to link objectives, quantifiable targets and performance measurement, and thereby 'align' the activities of the organisation. For example, guidance from the Next Steps Team (1995, p.40) on strategic management in the public sector extols the virtues of performance measurement and performance reporting, and, in respect of target setting, declares that 'the priorities and objectives set out in the organisation's long-term strategic plans should be used to set targets'. Similar sentiments appear fitting for all NFPOs, including charities, where it would seem appropriate that there should be measures of performance at each level of an organisation. At lower levels within the organisation these may tend to be quite specific and technical, whereas at higher levels the performance measures may be more general and subjective. Carter (1989) distinguishes between performance measures being used as either 'dials' or 'tin-openers'. Implicit in the use of performance measures as dials is the assumption that standards of performance are unambiguous. With tin-openers, there is the assumption that performance is a contestable notion. At the lower levels in the organisation it is more likely that the measures used will be more akin to dials, while the higher-level measures will tend to resemble tin-openers.

It is critical for the co-ordination of the measurement system that there is a proper relationship established between these low-level measures of performance and the high-level objectives of the organisation. Without such clear linkages, faulty 'steering' (Talbot,

1996) of the organisation may occur and result in ineffective and inefficient operations. This is particularly illustrated in a quotation from *The Economist* (1996, p.19):

*The toll of disasters that can be laid at the feet of management theory is rising ... a British government report into an escape from Parkhurst prison published last year complained that “any organisation which boasts one Statement of Purpose, one Vision, five Values, six Goals, seven Strategic Priorities and eight Key Performance Indicators, without any clear correlation between them, is producing a recipe for confusion”.*

As far as possible, the low-level measures should motivate managers to behave in a way that furthers the overall strategic mission of the organisation. However, as Hyndman and Eden (2000 and 2001) have argued, the degree to which such alignment can be achieved may depend on the extent to which the cause-and-effect relationships in the NFPO can be specified and on the the degree to which the ultimate outcomes of the NFPO are clear. (See page 24 for previous discussion on setting objectives.)

It is likely that in the vast majority of NFPOs, including charities, where there are a variety of objectives, many of which are difficult to specify in quantitative terms, establishing co-ordination between the high-level and low-level measures may be problematical. Throughout the process it must be realised that the most important performance measures are those that are related to the high-level objectives of the organisation. Low-level measures should be developed by reference to already developed high-level measures. Thompson (1995), in an analysis of the performance measurement systems of public art galleries, highlights the difficulties of achieving this. Similar difficulties in providing co-ordination were identified by Mol (1996) when reviewing performance systems used in the Dutch Department of Defence. He concluded that there was (p.73) ‘a lack of relevance of

individual indicators' and 'a lack of coherence of the indicator system, because relations between the indicators are insufficiently determined'. The development of high-level measures requires much thought and experimentation because it is often at this level in the organisation that there is the greatest vagueness about objectives.

In a relatively recent research publication, 'maps' (diagrammatic representations of linkages) of how individual public sector organisations have linked objectives and targets (in plans) to performance measures in annual reports have been provided by Hyndman and Eden (2001). For example, in the case of Driver and Vehicle Licensing (Northern Ireland), an objective related to the efficiency of the organisation, spawned a target of 'achievement of a unit cost of £21.73 per vehicle excise enforcement case completed' (both the objective and the target being included in the planning documents of the organisation) which was then used as a benchmark against which to report the actual performance of the organisation ('achieved unit cost of £19.49 per vehicle excise enforcement case completed') in the annual report. In the Hyndman and Eden study, this link, together with a number of other links for the same organisation, is shown in pictorial form. In addition, similar linkages are shown for other public sector organisations. Such visual 'mapping' may help organisations to improve co-ordination.

## **Conclusion**

Contributors to charities and other external parties have information needs, yet because they are not involved in the management of a charity they must primarily rely on the annual report to meet those information needs. Accountability involves explaining what has been, or is being, done and what has been planned. Two main types of information are important in discharging accountability: financial information as contained in traditional financial statements; and wider performance information, often of a non-financial nature, relating to the

efficiency and effectiveness of the charity. The importance of charities measuring and reporting on performance, which is a very different issue from a business measuring and reporting performance, has been recognised in a number of NFPO publications. It is argued that the inclusion of performance information in annual reports of charities will lead to a more accountable charitable sector and also provide a stimulus for better management within a charity. However, the many difficulties of designing a performance information system for a charity should not be overlooked. An awareness of these difficulties may help to focus attention on some of the important issues to be addressed by the system designer, and support the development of appropriate and well-balanced systems.

## **CHAPTER THREE**

### **PREVIOUS RESEARCH AND RECENT GUIDANCE**

It has been argued previously that the information needed to discharge accountability by charities may be extremely varied, and two important aspects of this are externally reported financial statement information and externally reported expressions of performance. This chapter reviews previous research related to the accountability of charities and provides an overview of guidance connected to performance reporting that may be useful to charities. Earlier research specifically focusing on the accountability of charities has concentrated on exploring financial accountability, and this is briefly reviewed. With regard to performance measurement and performance accountability, which are the subjects at the core of this research report, there has been limited research conducted specifically in the charity sector. What is available is examined, together with similar research in the wider not-for-profit sector. In addition, guidance linked to the development of performance measurement and performance reporting systems in NFPOs is reviewed. As before, there is limited charity-specific guidance available and this aspect of the chapter concentrates on that available in the public sector. Overall, this chapter provides a context in which to understand the empirical work presented later in chapter four.

## Previous research

### Research related to the financial accountability of charities

Previous research on the accountability of charities has focused on financial accountability, where it is argued that the quality of financial statements can be judged in terms of their compliance with the extant SORP (or generally accepted accounting principles). The work of Bird and Morgan-Jones (1981), which was based on an analysis of the annual reports and accounts of 135 charities and highlighted immense variety in charity accounting practices, brought the issue of charity accounting to the fore. Among the commonly identified contentious financial accounting treatments identified in the research were: legacies credited to capital rather than revenue; profits or losses on sale of investments accounted for in the capital account; the use of a provision or reserve for deferred expenses with the amount charged 'above the line'; and fixed assets, other than freehold property, written-off on acquisition. A major thrust of the conclusions of the research was that such a scenario was confusing, undermined confidence in the charity sector and possibly inhibited its potential growth. This research led to the setting up of a working party to (ASC, 1984, p.2) 'consider financial reporting by charities, in particular ways of enhancing the usefulness of charities' annual reports and the diverse practices of financial accounting and reporting adopted by charities'. Ultimately, this work, together with reports by the National Audit Office (1987) and Sir Philip Woodfield (the *Woodfield Report*, 1987) on the supervision and regulation of charities, contributed to the publication of the original SORP 2 *Accounting by Charities* (ASC, 1988).

A number of studies sought to assess the impact of the original SORP (ASC, 1988) shortly after its publication (Ashford, 1989; Gambling *et al*, 1990; and Hines and Jones 1992). Ashford reviewed the conformity of the 1988/89 accounts of 56 charities (grantmaking and

fundraising) with the SORP's requirements. The work concentrated on accounting policies, the content of the income and expenditure account, fixed asset accounting, investment valuation and legacies. While Ashford was able to illustrate a degree of compliance with the original SORP, providing 14 examples of 'good practice', he concluded that many charities continued to use dubious accounting practices, particularly in the area of accounting measurement. Gambling *et al* carried out a cross-sectional survey, utilising in-depth interviews, on the application of the original SORP in six charities. The research suggested that as the requirements set out in the original SORP are only recommendations, charities have little incentive to change their current practices. It was argued that this was particularly the case given the additional compliance costs. Hines and Jones conducted a longitudinal study of the reporting practices of 54 of the largest UK charities over the three years from 1988 to 1990 in order to assess whether or not the original SORP had a significant impact upon their accounting practices immediately after its introduction. The main conclusion from their work was that there was no evidence to suggest that it had.

Overall, these studies concluded that the impact of the original SORP was limited. In some charities it appeared that the SORP was being ignored, while key individuals in others were not even aware of its existence. One reason put forward for non-compliance was the lack of ownership of the original SORP by charities. Gambling *et al*, (1990, p.9) reported that 'the SORP reflected the opinions of the accounting profession about charity accounting, rather than those of the charities themselves'. Hines and Jones (1992) suggested that non-compliance with non-mandatory accounting standards was not surprising, and that mandatory accounting pronouncements or legislation was required.

In response to criticisms with regard to the weaknesses of, and non-compliance with, the original SORP (ASC, 1988), a committee sponsored by the Charity Commission in England and Wales was set

up to review the original SORP. This resulted in the publication of an exposure draft for a revised SORP (CARC, 1993), and in 1995 a revised SORP (CARC, 1995) was issued. Williams and Palmer (1998) sought to assess the state of charity accounting just prior to the introduction of the revised SORP. Using the work of Bird and Morgan-Jones (1981) as a benchmark, they examined the 1994/95 financial statements of 83 charities (classified into large, medium and small categories). While they concluded that there had definitely been progress among larger charities in improving the quality of financial reporting, they also found considerable variations in charity accounting practices still existing.

Subsequent to the publication of the revised SORP 2 (CARC, 1995), Connolly and Hyndman (2000) conducted an empirical analysis of the financial statements of the top 100 fundraising charities in the UK issued both before (1994/95) and after (1996/97) the publication of the revised SORP. The study suggested that while accounting by large charities had improved significantly since the 1980s (where improvement was seen in terms of increasing compliance with recommended practice), it would take time for the new recommendations contained in the revised SORP to be adopted by charities. Subsequent research by the same authors (Connolly and Hyndman, 2001), comparing UK charities with Irish charities, found evidence that the financial statements of Irish charities were significantly less compliant with SORP requirements than their UK counterparts.

When the 1995 SORP (CARC, 1995) was issued, a commitment was given by the Charity Commission to review the SORP after considering its impact. Following a consultation process started in September 1998, a further revision of the recommendations relating to charities was published in October 2000 (Charity Commission, 2000). These recommendations apply to accounting periods commencing on or after 1 January 2001. While SORP 2000 (Charity Commission,

2000) has been completely rewritten compared with the 1995 version, it does not propose any major changes to the structure of charity accounts (p.3) 'nor are there any new requirements which might be regarded as onerous'. The key changes include a revision of the recommended content of the trustees' annual report, the inclusion of sections explaining the relationship between the SORP and the law, guidance on accounting for separate funds and alterations to the presentation of incoming resources and resources expended in the SOFA. Of particular note are new recommendations relating to the reporting of risk and reserves. The empirical research identifying the current state of performance reporting by large UK charities (presented later in chapter four) does not focus on any of the detailed changes specifically required by SORP 2000, although some consideration of these has been provided by Chitty (2002) who suggests that charities have been slow to respond to recent additional recommendations.

### **Research related to the performance accountability of charities**

There has been limited research in the charity sector relating to performance accountability. With regard to the external reporting of performance information by charities, two studies by Hyndman (1990 and 1991) provide some insights. Based upon an analysis of the annual reports of 163 large UK charities and a survey of 133 contributors to such charities, Hyndman (1990) sought to identify the information that is routinely made available to contributors through the annual report, and the most important information sought by contributors to charities. In the study, contributors were asked to rank 14 types of financial and non-financial information, including frequently disclosed information, in terms of importance to them using a five-point Likert scale (1 = not important to 5 = of vital importance). This was compared with the information routinely made available to them in the annual report. A summary of the results of this comparison is shown in Table 3.1.

**Table 3.1 Comparison of Disclosure and Importance of Different Types of Charity Annual Report Information (Hyndman, 1990)**

Type of information	Disclosure of information		Importance to contributors of information	
	% of charities disclosing	Rank in terms of disclosure	Mean score in terms of importance <sup>a</sup>	Rank in terms of importance
Audited operating statement	91	1	3.05	11
Audited balance sheet	89	2	2.83	12
Audited funds flow statement	58	4	2.66	=13
List of officers	83	3	2.66	=13
Statement of goals	38	5	4.44	1
Statement of objectives	0	14	3.70	6
Information on problem or need area	5	=10	3.98	2
Measures of output	29	6	3.90	4
Measures of efficiency (non-financial)	2	12	3.73	5
Administration cost %	19	8	3.95	3
Simplified operating statement	21	7	3.48	8
Simplified balance sheet	6	9	3.16	10
Statement of future objectives	1	13	3.67	7
Budget information	5	=10	3.46	9

<sup>a</sup>The higher the mean, the greater the importance.

As can be seen from Table 3.1, Hyndman (1990) found that while audited financial statements dominated reporting by charities, contributors viewed other information, particularly that relating to performance, as most important. The seven most important information types identified were (in order of importance): a statement of goals of the charity; information relating to the general problem or need area with which the charity was dealing; administration cost information (a financial indicator of efficiency); measures of the output of the charity; non-financial efficiency measures; a statement of the current objectives of the charity; and a statement of the future objectives of the charity. Three of the four least important information types were (in decreasing order of importance): audited operating statement; audited balance sheet; and audited funds flow statement. However, two of these were the most frequently disclosed (operating statement and balance sheet) of all the 14 information types, while the other (funds flow statement) was the fourth most frequently disclosed information type. Hyndman argued that many of the most important types of information sought by contributors relate to the assessment of performance, and suggested that the seven most important information types (indicated above) could all be connected to past or future performance.

In a related study, Hyndman (1991) investigated whether the identified 'relevance gap', the difference between the information disclosed by charities in their annual reports (mainly audited financial statement information) and the information required by contributors (mainly performance-related information), was due to a lack of awareness on the part of the providers of the information. The objectives of the paper were to identify the views of providers of information regarding the importance of contributors as users of charity reports, and to ascertain the perceptions of such providers concerning the importance to contributors of the 14 information types used as the basis for previous study (Hyndman, 1990). Two key groups involved in the provision of information to contributors (charity officials and auditors of charity financial statements) were surveyed using questionnaires (one questionnaire for each provider group). As

well as identifying the perceived importance of contributors as users of charity annual reports (with both groups of providers overwhelmingly identifying contributors as the user group to whom the annual report is primarily directed), the major part of each questionnaire asked charity officials and auditors to rate the 14 information types in terms of perception of importance to contributors. These perceptions were then compared with the actual importance to contributors identified in the previous study. A total of 148 charity officials and 74 auditors were surveyed. Similar to before, the charity officials and auditors rated the 14 information types in terms of perception of importance to contributors using a five-point Likert scale (1 = not important to 5 = of vital importance). The responses of the three groups (contributors, charity official and auditors) were analysed using mean ranks and non-parametric statistical tests were used to identify statistical differences.<sup>1</sup> A summary of the comparisons is shown in Table 3.2.

**Table 3.2** *Importance to Contributors of Different Types of Charity Annual Report Information: Comparisons of Contributors, Charity officials and Auditors (Hyndman 1991)*

Type of information	Contributors		Charity Officials	
	Mean score in terms of importance <sup>a</sup>	Rank in terms of importance	Mean score in terms of importance <sup>a</sup>	Rank in terms of importance
Audited operating statement	3.05	11	3.31	10
Audited balance sheet	2.83	12	3.53	7
Audited funds flow statement	2.66	=13	2.73	14
List of officers	2.66	=13	2.84	=12
Statement of goals	4.44	1	4.29	1
Statement of objectives	3.70	6	3.59	6
Information on problem or need area	3.98	2	4.26	2
Measures of output	3.90	4	3.97	3
Measures of efficiency (non-financial)	3.73	5	3.83	5
Administration cost %	3.95	3	3.86	4
Simplified operating statement	3.48	8	3.32	9
Simplified balance sheet	3.16	10	3.28	11
Statement of future objectives	3.67	7	3.35	8
Budget information	3.46	9	2.84	=12

<sup>a</sup>The higher the mean, the greater the importance.

*Table 3.2 (Continued)*

Type of information	Auditors		Statistical Significance (Kruskal-Wallis test) at 1% or 5% level
	Mean score in terms of importance <sup>a</sup>	Rank in terms of importance	
Audited operating statement	3.57	5	5%
Audited balance sheet	3.48	7	1%
Audited funds flow statement	2.40	14	No
List of officers	2.68	13	No
Statement of goals	4.33	1	No
Statement of objectives	3.49	6	No
Information on problem or need area	3.86	3	1%
Measures of output	3.90	2	No
Measures of efficiency (non-financial)	3.41	9	1%
Administration cost %	3.73	4	No
Simplified operating statement	3.27	10	No
Simplified balance sheet	2.97	11	5%
Statement of future objectives	3.43	8	5%
Budget information	2.95	12	1%

<sup>a</sup>The higher the mean, the greater the importance.

As can be seen from Table 3.2, charity officials and auditors are largely aware that the most important information that contributors require is related to performance. With both charity officials and auditors, at least five out of the top six highest ranked information types were the same as contributors. In fact, with each of the three groups (contributors, charity officials and auditors) the same four information types were ranked in the first four places (goals, information on problem or need area, measures of output and administration cost percentage information). However, even though providers of information are aware of the information needs of contributors, and contributors are identified as the most important user of the annual report, the majority of charities do not disclose such information (see Hyndman, 1990). For example, only 38 per cent of charities disclosing information on their goals (the most disclosed of any of the four highest ranked types of information).

The statistical tests in the study showed that there were no significant differences, at normal levels of significance, between the actual/perceived importance of the three groups (contributors, charity officials and auditors) regarding three of the four most important information types identified by contributors (statement of goals, measures of output and administration cost percentage information). A significant difference (at the 1 per cent level of significance) existed with information concerning the general problem or need area, with (as can be seen in Table 3.2) charity officials perceiving it to be more important than contributors and auditors. However, although such a perception by a provider of information may have encouraged the external reporting of such information, only 5 per cent of charities disclosed information on the general problem or need area with which the charity was dealing (see Table 3.1).

The research also provided evidence of differences between the importance of audited financial statement information to contributors and the perception of importance to contributors by providers of

information (charity officials and auditors), particularly with regard to operating statements and balance sheets. As can be seen in Table 3.2, the audited operating statement was ranked fifth by auditors (mean rank 3.57), tenth by charity officials (mean rank 3.31) and eleventh by contributors (mean rank 3.05). With audited balance sheet information, this was ranked seventh by both charity officials and auditors (with mean ranks of 3.53 and 3.48 respectively) but only twelfth by contributors (mean rank 2.83). Furthermore, these differences were statistically significant at normal levels of significance (at the 5 per cent and 1 per cent levels respectively). As is seen in the previous study (Hyndman, 1990), these two information types are the most frequently disclosed, with approximately 90 per cent disclosure in each case.

Overall, the research discounted the possibility that the 'relevance gap' is caused by providers of information being unaware of the information needs of contributors. Rather, it argued that accountability to contributors is not discharged in the most effective manner, with limited reporting of performance information to contributors. In addition, Hyndman (1991) suggested that there may be a general complacency among the providers of information with regard to the adequacy of existing reporting procedures, given that they know what is important but do not disclose, and limited motivation to improve accountability to contributors.

While the previous two studies have focused on external reporting by charities, and in particular the external reporting of performance information, Wise (1995) provides some evidence of the paucity of performance information available internally to charity managers. Wise asked the representatives of 54 charities (subdivided into small, medium and large charities) to provide details of the information made available to, and used by, managers in their charity. One of the main findings of the research was that while many of the charities had some non-financial performance information available at routine management meetings (with large charities having more than small charities), an

examination of the detail of the information highlighted certain deficiencies. In particular, most of the performance indicators focused upon input or output volumes rather than concepts of efficiency or effectiveness. Furthermore, while the majority of respondents believed that their trustees were able to assess the performance of their charity, few could suggest how performance improvement might be measured. Wise asserted that these findings demonstrated significant weaknesses in the information systems of charities and undermined efforts to plan and control effectively. Obviously such findings provide some further insights into the conclusions of the two Hyndman (1990 and 1991) papers.

### **Research related to the performance accountability of other NFPOs**

A research study from the United States by Brace, Elkin, Robinson and Steinberg (1980), part of the FASB's conceptual framework project on NFPOs, reviewed 120 reports prepared by six types of NFPO (colleges and universities, hospitals, human service organisations, state and local government units, trade and professional associations, and philanthropic foundations). The study team's objective was to record and classify instances in which these organisations reported on their organisation performance using service efforts and accomplishments information. The approach taken in defining service efforts and accomplishments was based upon systems theory. Four aspects of the system were identified (inputs, processes, outputs and results), and measures of efficiency and effectiveness were recognised by relating various aspects of the system to each other. For example, efficiency measures were classified as those that related the organisation's efforts (or inputs) to its outputs. Inputs and processes information was classified as being related to 'efforts', whereas outputs and results information was categorised as being related to 'accomplishments'. The data for the

research came mainly from annual general-purpose reports (35 out of the 120 documents analysed) and summary annual reports (46 out of the 120 documents analysed). Other types of reports incorporated in the analysis included internal management reports and budget requests for funds. The results of the analysis are presented in Table 3.3 that shows the number of instances of reporting inputs, processes, outputs, results, efficiency and effectiveness by NFPO type and in total, and the average number of disclosures by NFPO type and in total.

**Table 3.3 Measures of Performance in Different Types of NFPO**  
(Brace, Elkin, Robinson and Steinberg, 1980)

Type of NFPO	Number of Documents	Inputs	Processes	Outputs
Colleges and Universities	20	63	63	28
Hospitals	20	66	44	57
Human Service Organisations	20	20	41	85
State and Local Government Units	20	53	54	91
Trade and Professional Associations	20	24	70	58
Philanthropic Foundations	20	50	32	24
Total	120	276	304	343
Average per Document		2.30	2.53	2.86

**Table 3.3 Measures of Performance in Different Types of NFPO**  
*(Brace, Elkin, Robinson and Steinberg, 1980)*  
*(Continued)*

Type of NFPO	Results	Efficiency	Effectiveness	Average per Document
Colleges and Universities	10	4	0	8.40
Hospitals	8	20	0	9.75
Human Service Organisations	15	4	0	8.25
State and Local Government Units	38	28	15	13.95
Trade and Professional Associations	26	0	2	9.00
Philanthropic Foundations	15	1	1	6.15
Total	112	57	18	
Average per document	0.93	0.48	0.15	9.25

Overall, 1,110 instances of reporting service efforts and accomplishments information were recorded using Brace *et al's* (1980) model. As can be seen in Table 3.3, information on efforts was more readily found than information on accomplishments. In addition, information on efficiency, although limited in usage, was more prevalent than information on effectiveness. The vast majority of documents had little or no information on effectiveness. In terms of NFPO sector, state and local government units had significantly more disclosures, particularly with regard to efficiency and effectiveness, than the other sectors. The researchers concluded that, although the use of performance reporting was limited, the usefulness of such information

was heavily implied by the extent to which (p.ii) 'powerful resource providers' require it from NFPOs.

Part of a wider UK study by Hyndman and Anderson (1997) sought to identify the type and extent of the reporting of performance information in the annual reports of executive agencies (agencies) and the change over time. Agencies are part of the UK central government that have, since 1988, been somewhat decoupled from central control and operate as *quasi*-autonomous units. There are over 130 such organisations, representing approximately 75 per cent of central government activity, and they vary greatly in terms of size and function. Examples of such organisations include the Social Security Benefits Agency (with over 70,000 employees), HM Prison Service (with over 35,000 employees), Historic Scotland (with approximately 600 employees) and the National Weights and Measures Laboratory (with fewer than 100 employees). Each agency is required to produce an annual report and accounts for each year, and four sets of agency annual reports up to the year 1993/94, covering different time periods, were collected and analysed in this research. The model used in the research was based on a simple three stage classification capturing inputs, outputs and results (the component parts of performance) which permitted efficiency to be measured by relating inputs to outputs or results, and effectiveness to be measured by relating outputs or results to the objectives and targets. Efficiency and effectiveness were referred to as the higher measures of performance.

The initial analysis classified the information into five main types: inputs, outputs, results, efficiency and effectiveness. The percentage of agencies disclosing any effectiveness or efficiency information by year is shown in Table 3.4. The average number of measures, classified into three groups comprising the component parts of performance (that is inputs, outputs and results) as group one, efficiency (group two) and effectiveness (group three), is shown in Table 3.5. Examples of measures of efficiency and effectiveness found in the annual reports from the Hyndman and Anderson (1997) study are provided in appendix one (shown by agency).

**Table 3.4 Measures of Efficiency and Effectiveness in the Annual Reports of Agencies (Hyndman and Anderson, 1997)**

	<b>Efficiency</b>			
	<b>First Annual Reports</b>	<b>1991/92 Annual Reports</b>	<b>1992/93 Annual Reports</b>	<b>1993/94 Annual Reports</b>
No. of Annual Reports	29	57	71	88
Percentage disclosing at least one measure	38%	58%	54%	57%

	<b>Effectiveness</b>			
	<b>First Annual Reports</b>	<b>1991/92 Annual Reports</b>	<b>1992/93 Annual Reports</b>	<b>1993/94 Annual Reports</b>
No. of Annual Reports	29	57	71	88
Percentage disclosing at least one measure	59%	86%	94%	92%

**Table 3.5** *Average Number of Performance Disclosures per Agency Annual Report (Hyndman and Anderson, 1997)*

	<b>First Annual Reports</b>	<b>1991/92 Annual Reports</b>	<b>1992/93 Annual Reports</b>	<b>1993/94 Annual Reports</b>
Inputs, Outputs and Results	8.99	5.18	5.95	10.05
Efficiency	1.03	1.63	1.61	2.09
Effectiveness	3.83	6.75	7.60	7.09
Total	13.85	13.56	15.16	19.23

The study found that although there was a significant proportion of agencies reporting little or no information on efficiency and effectiveness in their annual reports, overall, the reporting of performance had improved over time. As can be seen from Table 3.4, only 57 per cent of agencies reported at least one measure of efficiency (that is, 43 per cent of agencies did not report a single measure of efficiency) in their 1993/94 annual reports, with non-disclosure for earlier years being even more pronounced. The comparable figure for non-disclosure of measures of effectiveness for 1993/94 was 8 per cent. While the research did not attempt to judge the appropriateness of particular measures, it was argued that given the explicit call for agencies to publish information on performance, and the provision of focused guidance by central government, a lack of publication of measures of efficiency and effectiveness points to an agency sector where performance accountability is not discharged in an adequate manner. However, the number of performance disclosures per annual report, as is seen in Table 3.5, increased in total by approximately 40 per cent over the

four accounting periods considered, from 13.85 (first annual reports) to 19.23 (1993/94 annual reports). In addition, the study showed an increased emphasis in the later annual reports with regard to the use of the higher measures of performance (that is efficiency and effectiveness). These changes were viewed as improvements, and it was argued that they possibly suggest an evolution of performance reporting.

## **Guidance in reporting performance**

### Charity guidance

#### ***Government***

The government's Strategy Unit published its much anticipated study of the legal and regulatory issues relating to charities entitled *Private Action, Public Benefit* (Cabinet Office, 2002; see appendix two as to how this can be accessed directly *via* the internet) on 25 September 2002. The objectives of the study were to:

- map the wider not-for-profit sector;
- clarify government strategy towards the sector;
- review the legal and statutory framework; and
- make recommendations for the removal of unnecessary legal restrictions.

Overall, the consultation document, which runs to almost 100 pages, contains 61 recommendations, a number of which would require changes to legislation. The coverage of the study is much broader than the subject of this research report, and among some of the radical wider points included were: a call for the replacement of the 400-year-old definition of charity; proposals for new types of company for charities and social enterprises; and suggestions modernising the role of the Charity Commission. Chapter six of the study focused on the need for better information as a basis for building trust and

confidence in the sector, and on supporting the sector in improving performance.

The inadequacies of the present state of reporting were highlighted. For example, it is argued (Cabinet Office, 2002, p.59):

*There is some evidence to suggest that, in general, charities and other not-for-profit organisations are not producing information which is sufficiently accessible and relevant to the public's needs. Credible comparative information about impact is particularly lacking. This could in the longer term undermine public trust and confidence.*

A number of performance-related issues are addressed in the document. Perhaps the most far-reaching in terms of performance reporting is the suggestion that charities with incomes of over £1,000,000 should complete a Standard Information Return annually. This would highlight qualitative and quantitative information about the charity, focusing on the charity's impact, how it sets its objectives and measures its performance against these. The information would then be made available in a user-friendly format on the Charity Commission website. The Standard Information Return is expected to require trustees to address certain areas and answer a number of questions, including the following:

- Achievement against objectives  
What were your objectives for last year and how far did you achieve them? What are your objectives for the coming year and how will you achieve them?
- Impact  
How do you measure your impact? What are your success measures?
- Performance Improvement  
Do you use any of the following recognised quality tools? (tick boxes) Social Audit; Excellence Model; Practical Quality Assurance

System for Small Organisations (PQASSO); Investors in People; *etc.*

- Stakeholder Involvement  
Whom do you see as your main stakeholders? How do you ensure accountability to them? How do you listen to and act on their views?
- Governance  
How are your trustees selected and equipped for their role?
- Fundraising  
What fundraising activities do you undertake and why? Fundraising ratio for the last year and averaged over the last five years, with explanatory text.

To support the relevance, accuracy and comparability of this new information, the consultation document suggests that the SORP be amended to improve methods of apportioning costs and expenditure, enabling more meaningful financial comparisons between organisations, and that there should be an increased focus on achievements against objectives, organisational impact and future strategy. In addition, in order to confer some external scrutiny, the intention is that the information provided should be professionally audited, and where possible should make the use of accredited processes (such as the use of accredited quality tools).

It is argued that there is a challenge in balancing openness with brevity, and it is suggested that this new statement should not be more than two pages of A4. It is stated that there has been insufficient focus on measuring and improving performance in the charitable sector, partly due to the difficulties in developing immediate indicators of performance, unlike in the business sector. It is recommended that government provide support to the sector for work on performance improvement, and that organisations involved in the same area of

service should pilot test an approach to develop common performance indicators.

After a period of consultation, with submissions having been made by 31 December 2002, it is expected that the Home Office's Active Communities Unit (ACU), in partnership with other departments and agencies as appropriate, will publish a paper in 2003 setting out the government's next steps and strategy, together with an implementation plan for the recommendations arising from the consultation document. As many of the recommendations can only be implemented by primary legislation, it is expected that the necessary legislation will be included in a Home Office Bill. It is argued that the proposals represent an effective framework for the future growth of the sector, however success will depend in part on the role played by the sector itself, including the key umbrella and infrastructure organisations. The possible impact of any changes emanating from such a process on performance reporting is unclear, especially as it could take some years for the necessary legislative changes to be made, although the major themes of the performance reporting aspects of the document are to be welcomed. Overall, although there is very little detail in the document on the mechanics of developing performance measurement and performance reporting systems for charities, the principles expounded and the suggestion that necessary guidance and support will be forthcoming to encourage change, intimate positive change may occur. Indeed, the emergence of government as such a 'champion of change' with regard to performance reporting in the charity sector is perhaps a necessary catalyst to the process.

### CAF guidance

Over a number of years the CAF has prepared guidance, specifically linked to their charities' annual report and accounts awards, to assist charities with the preparation of 'the best possible annual report and

accounts' (CAF, 2001; see appendix two as to how this can be accessed directly *via* the internet).<sup>2</sup> Charities are encouraged to decide who their target audiences are and the messages that they wish to send before any work is done on the annual report. Although the guidance does not provide extensive, detailed examples of what might be reported, principles relating to the publication of the annual report and accounts of a charity are given under three headings: what the judges look for in entries to the awards process; a checklist for the use of those preparing a charity's annual report and accounts; and a checklist of common faults to be avoided. With regard to performance reporting a number of suggestions are made, including:

- The objectives of the charity should be clearly stated early in the document. The achievements should be set out and related to the charity's overall aims, to longer-term trends and to future plans. The guidance highlights a common fault of failing to state clearly, and at an early point in the report, the charity's objectives, what has been achieved during the year to meet those objectives and what is intended for the following year;
- Do not presume an existing level of awareness of the charity when explaining about a charity's activities. For instance, do not report back on the completion of an activity without expressing the original aim and objective;
- Emphasise successes through comparative charts and graphs rather than lengthy copy. It can be useful to gain quotes from users, beneficiaries, students, *etc.* Quotes can provide independent 'proof' that a charity is fulfilling its aims and objectives effectively;
- Statistical information, if chosen carefully and presented attractively, can give a picture of the success and progress of the charity's activities. It can include non-financial, qualitative and quantitative information, such as details of: levels and activities of voluntary

help; number of users; grant-giving patterns, areas of research; number of operations; and improvements in medical techniques;

- Success can also be measured in terms of the money, staff and administration costs involved to give a concise and visual picture of how efficient a charity has been in its use of resources.

The guidance also stresses that a charity's report and accounts should provide a stimulus to potential donors and encourage participation. In addition, the organisation of the information within the report and accounts is emphasised as being vitally important to how well the message is conveyed. The need for a coherent report that does not flit from subject to subject is stressed, and the use of headings, charts, maps, statistics and pictures to break up the text is recommended. Overall, both the accountability and marketing aspects of the report are highlighted. For example, it is argued that charities can use it (p.3) 'not only to "account" to major supporters but to put a strong case for further support'. It is suggested that stating past achievements and future plans, backed up by clear accounts, shows a charity as being well run, enhances the case for future support and reassures users and beneficiaries.

## **Public sector guidance**

Performance measurement has been promoted as an integral part of the management and accountability of the modern UK public sector. While there has been little guidance with regard to performance measurement in the charitable sector, there has been a profusion of support for those tasked with developing performance measurement and performance reporting systems in the public sector, particularly over the last decade. Many public sector organisations, which are part of the wider not-for-profit sector to which charities belong, display similar characteristics to charities: they have operating purposes that

are other than to provide goods or services at a profit; they receive significant amounts of resources from resource providers who do not expect to receive either repayment or economic benefits proportionate to the resources provided; and they have an absence of a defined ownership interest that can be sold, transferred or redeemed. The public sector is extremely diverse (covering government departments, non-departmental public bodies, schools, hospitals, executive agencies, local authorities *etc.*), as is the charitable sector (social welfare charities, children's charities, medical research charities, heritage charities, overseas aid charities *etc.*), and the difficulties of measuring performance in the public sector are often similar to those faced by charities. Indeed, it appears reasonable to suggest that much of the general public sector guidance on measuring performance can be 'read across' to the charity sector. To provide a comprehensive outline of such guidance is beyond the scope of this research report, but two useful UK publications are summarised below, with references to several other UK and international publications that can be accessed via the internet being provided in appendix two.

Following a report by the Efficiency Unit (1988), agencies were created under the Next Steps Initiative with the stated aim of delivering (*Next Steps Briefing Note*, April 1996, p.1) 'government services more efficiently and effectively within available resources for the benefit of taxpayers, customers and staff'. Performance measurement and performance reporting were emphasised for this very diverse segment of central government. A HM Treasury guide on performance measurement was published in 1992. Although the guide, *Executive Agencies: A Guide to Setting Targets and Measuring Performance* (HM Treasury, 1992), was specifically focused on agencies, it was noted that it was applicable to all parts of the public sector. Among the key advice given in the guide was the following:

- No agency ought to be set more than a handful of key targets, although there will be others set internally by the chief executive;
- The targets will usually fall under one or other of the following broad headings: financial performance (which means the corporate financial performance of the agency); volume of output; quality of service (including standards of service which individual users can expect to receive); and efficiency (including cost per unit of output);
- It is important that an explicit balance should be decided between the targets set for quality of service, and those covering volume of output and efficiency. Value for money judgements can only be made by assessing both inputs and outputs together;
- In deciding on the level of targets, prior year trend data or external data can be used to inform the process. Where trend figures are used they should be calculated on a consistent basis;
- Targets should normally be proposed and set as part of a corporate planning process;
- Progress against the key targets should be monitored during the year;
- Achievements against key targets should be included in the annual report and accounts of the agency.

With regard to the four categories of target (financial performance, volume of output, quality of service and efficiency), the importance of each is discussed and examples from agencies are provided. Examples provided in the guidance, together with the agency using the target, are shown in Table 3.6. In relation to financial performance targets, it is recommended that the agency's accounting and management information systems distinguish clearly the different activities (including the attribution of overhead costs to each category), and

financial measure and indicators are available for any commercial activities that are undertaken. In the case of output targets, the fact that an agency often has a choice about what to regard as output is stressed. For example, the guidance states that an agency such as the Civil Service College can equally well regard its output as the number of course-days provided or the number of student-days taught, both combined, hopefully, with quality indicators. It is noted that the choice is especially wide when the nature of the output varies (*eg* with research agencies). A distinction is drawn between ‘intermediate outputs’ (a step towards producing something) and ‘final outputs’ (the ultimate outcome). For example, it is argued that the final output of vehicle testing may be such things as the impact on road safety or environmental pollution, but for the purposes of determining targets it is preferable to concentrate on the direct outputs (possibly because the final output may occur much later than the intermediate output and is often affected by various factors unrelated to the action of the agency). The importance and diverse nature of quality targets is illustrated by the fact that these are categorised into those relating to the quality of the product (*eg* accuracy) and those relating to aspects of the process of delivery (such as timeliness, turnaround time and customer-supplier relationship). In relation to efficiency targets, as well as stressing the importance of unit cost figures, the link between efficiency and economy is emphasised, and it is contended that one way to improve efficiency is to reduce the costs of inputs.

**Table 3.6 Examples of Agency Targets by Category (HM Treasury, 1992)**

<b>FINANCIAL PERFORMANCE</b>	
<b>EXAMPLE</b>	<b>AGENCY</b>
<ul style="list-style-type: none"> <li>• Full cost recovery on priced services</li> </ul>	<ul style="list-style-type: none"> <li>• Civil Service College and Central Office of Information</li> </ul>
<ul style="list-style-type: none"> <li>• Commercial revenue to offset costs</li> </ul>	<ul style="list-style-type: none"> <li>• Met Office</li> </ul>
<ul style="list-style-type: none"> <li>• Surplus on commercial activities</li> </ul>	<ul style="list-style-type: none"> <li>• Historic Royal Palaces</li> </ul>
<b>VOLUME</b>	
<ul style="list-style-type: none"> <li>• Number of charts produced for navigators</li> </ul>	<ul style="list-style-type: none"> <li>• Hydrographic Office</li> </ul>
<ul style="list-style-type: none"> <li>• Number of tests performed</li> </ul>	<ul style="list-style-type: none"> <li>• Vehicle Inspectorate</li> </ul>
<ul style="list-style-type: none"> <li>• Number of projects completed</li> </ul>	<ul style="list-style-type: none"> <li>• Central Veterinary Laboratory</li> </ul>
<ul style="list-style-type: none"> <li>• Arrange 1,300,000 placings for people into jobs, of whom 16% are to be long term claimants, 2.4% to be people with disabilities, 34% to be unemployed people in inner cities</li> </ul>	<ul style="list-style-type: none"> <li>• Employment Service</li> </ul>
<ul style="list-style-type: none"> <li>• Complete 200 units of the resurvey of listed buildings and make 400 historic building repair grants</li> </ul>	<ul style="list-style-type: none"> <li>• Historic Scotland</li> </ul>

**Table 3.6 Examples of Agency Targets by Category (HM Treasury, 1992) (Contd)**

<b>FINANCIAL PERFORMANCE</b>	
<b>EXAMPLE</b>	<b>AGENCY</b>
<b>QUALITY OF SERVICE</b>	
<ul style="list-style-type: none"> <li>• Same day clearance for Social Fund crisis loans</li> </ul>	<ul style="list-style-type: none"> <li>• Benefit Agency</li> </ul>
<ul style="list-style-type: none"> <li>• Time to handle applications</li> </ul>	<ul style="list-style-type: none"> <li>• Passport Office and Vehicle Certification Agency</li> </ul>
<ul style="list-style-type: none"> <li>• Time to issue patent search reports</li> </ul>	<ul style="list-style-type: none"> <li>• Patent Office</li> </ul>
<ul style="list-style-type: none"> <li>• Error rate in the value of benefit payments</li> </ul>	<ul style="list-style-type: none"> <li>• Employment Service</li> </ul>
<ul style="list-style-type: none"> <li>• 95% business complaints handled within 5 days</li> </ul>	<ul style="list-style-type: none"> <li>• Radio communications agency</li> </ul>
<ul style="list-style-type: none"> <li>• 85% overall customer satisfaction rating</li> </ul>	<ul style="list-style-type: none"> <li>• Recruitment and Assessment Services Agency</li> </ul>
<ul style="list-style-type: none"> <li>• All documents to be available within 5 days of receipt</li> </ul>	<ul style="list-style-type: none"> <li>• Companies House</li> </ul>
<b>EFFICIENCY</b>	
<ul style="list-style-type: none"> <li>• £20.89 for a car test</li> </ul>	<ul style="list-style-type: none"> <li>• Driving Standards Agency</li> </ul>
<ul style="list-style-type: none"> <li>• £472 per productive professional day</li> </ul>	<ul style="list-style-type: none"> <li>• Occupational Health Service</li> </ul>
<ul style="list-style-type: none"> <li>• Reduction in the ratio of support costs to total cost</li> </ul>	<ul style="list-style-type: none"> <li>• Laboratory of the Government Chemist</li> </ul>
<ul style="list-style-type: none"> <li>• 8.7% efficiency increase in the use of accommodation</li> </ul>	<ul style="list-style-type: none"> <li>• Recruitment and Assessment Services Agency</li> </ul>

Another more recent public sector guide, *Choosing the Right Fabric (a framework for performance information)* (HM Treasury, 2001), was produced jointly by HM Treasury, Cabinet Office, National Audit Office, Audit Commission, and the Office for National Statistics with the aim of providing the public sector with a synthesis of the key concepts and ideas behind good performance information practices. The 35 page long document (which can be downloaded from the internet; see appendix two) considers the type of information that is worth collecting as performance information, and the principles behind pulling together a set of performance measures. The role of performance information and the practical issues in putting a performance information system in place are discussed, and pointers to further sources of information and guidance are provided. It is acknowledged that the material provides a guide, or framework, for looking at performance information, not hard and fast rules, as it is (p.3):

*... rarely possible to have the perfect performance measure – defining measures, setting targets and collecting performance information is a balancing act between using the ideal information and using what is possible, available, affordable, and most appropriate to the particular circumstances.*

The importance of performance information in strategy, policy development, business planning, performance management and accountability are discussed, and the importance of ensuring that high-level business plans are ‘cascaded’ through the organisation by the use of targets and performance measures is illustrated. A production model utilising inputs, outputs and outcomes (in a health-care environment, it is suggested that examples of these might be drugs purchased, people treated and improved health, respectively) is provided and, in this context, the difficulty of approximating anything like perfect measures is again stressed. It is stated that (p.3):

*Ultimately, we are aiming to improve outcomes, and so should measure them. But sometimes outcomes can be hard to measure. And we need to understand how inputs and outputs and associated processes are contributing to outcomes.*

Throughout the guide, examples are provided. In the discussion on inputs, outputs and outcomes, the terms are defined (with examples provided) and considered in relation to economy, efficiency and effectiveness. This is illustrated in Table 3.7, using material adapted from the guide.

**Table 3.7 Examples of Inputs, Outputs and Outcomes, and Relationship to Economy, Efficiency and Effectiveness (adapted from HM Treasury, 2001)**

INPUTS, OUTPUTS AND OUTCOMES	ECONOMY, EFFICIENCY AND EFFECTIVENESS
<p><b>Inputs:</b> The resources that contribute to production and delivery. Inputs commonly include things such as labour, physical assets, and IT systems. For example, doctors, nurses, or scanning equipment.</p>	<p>An <b>Economy</b> measure looks at the costs of acquiring the inputs to the programme. For example, what is the cost of drugs for a certain treatment?</p>
<p><b>Outputs:</b> The final products, or goods and services, produced by the organisation for delivery to the customer. For example, the number of effective medical treatments or operations that take place (of the appropriate quality).</p>	<p>An <b>Efficiency</b> measure looks at whether the maximum output is being achieved for the inputs that go into the process. For example, for given hospital facilities, and standards of care, how many patients are being treated?</p>
<p><b>Outcomes:</b> The impacts, or consequences for the community, of the activities of the government. Outcomes are normally what an organisation is trying to achieve. For example, longer life expectancy and better health.</p>	<p>An <b>Effectiveness</b> measure looks at whether the outputs of the programme lead to the desired outcomes. Trying to measure effectiveness is particularly important where there are lots of influences outside the organisation that will affect the outcomes. For example, estimates of the number of people giving up smoking because of an anti-smoking campaign would give an indication of the effectiveness of that campaign in improving people's health</p>

The major part of the guide (sections four and five) deals with two questions: what makes a good performance information system, and what makes a good performance measure? With regard to the first question, six key criteria (which produce the acronym FABRIC used in the title to the guide, see Table 3.8) are presented that, it is claimed, will help in designing an effective performance information system. These focus on the requirements for the performance information system overall (by system is meant the process of producing and disseminating performance data, and painting a complete picture of the organisation) rather than for individual measures. Regarding the issue of a good performance measure, the guide suggests eight criteria that good performance measures should meet. The six performance-information system criteria, together with the eight performance-measures criteria are summarised in Table 3.8.

**Table 3.8** *Criteria that Performance Measures and Performance Information Systems Should Meet (adapted from HM Treasury, 2001)*

<b>A GOOD PERFORMANCE INFORMATION SYSTEM IS:</b>	<b>A GOOD PERFORMANCE MEASURE IS:</b>
Focused on the organisation's aims and objectives.	<b>Relevant</b> to what the organisation is aiming to achieve.
Appropriate to, and useful for, the stakeholders who are likely to use it.	Able to <b>avoid perverse incentives</b> and not encourage unwanted or wasteful behaviour.
Balanced, giving a picture of what the organisation is doing, covering all significant areas of work.	<b>Attributable.</b> The activity measured must be capable of being influenced by actions which can be attributed to the organisation; and it should be clear where accountability lies.
Robust in order to withstand organisational changes or individuals leaving.	<b>Well-defined</b> , with a clear, unambiguous definition so that data will be collected consistently, and the measure is easy to understand and use.
Integrated into the organisation, being part of the business planning and management processes.	<b>Timely</b> , producing data regularly enough to track progress quickly enough for the data to be useful.
Cost effective, balancing the benefits of the information against the costs.	<b>Reliable.</b> Accurate enough for its intended use and responsive to change.
	<b>Comparable</b> with either past periods or similar programmes elsewhere.
	<b>Verifiable</b> , with clear documentation behind it, so that the processes which produce the measure can be validated.

Each one of the above criteria is discussed in the guidance and a number of illustrations are provided. For example, in the case of the system being appropriate (the A in FABRIC), the need to consider who will use the information and how and why it will be used is emphasised, as is the importance of consulting with different stakeholders to ensure that the system produces data that is relevant to them. The fact that different stakeholders may have different needs for the performance information, and possibly different perspectives on what constitutes ‘good’ performance, is highlighted. A health care example is used (see Table 3.9) to illustrate this, with it being suggested that it may be necessary to tailor performance information for different users.

**Table 3.9** *Developing an Appropriate Performance Information System: Meeting Different Stakeholders’ Information Needs (adapted from HM Treasury, 2001)*

STAKEHOLDER	POSSIBLE INFORMATION NEEDS
Patients	Waiting times for treatment; measures of effectiveness of treatment.
Groups of patients with specific needs	Availability of multi-lingual services; availability of services to help people with disabilities; availability of 24-hour services for specific conditions.
Management	Measures of cost per treatment; number of people treated.

As before, with regard to the choice of specific performance measures each one of the eight criteria is discussed at length and examples are provided. For example, the avoidance of perverse incentives is given as an important criterion (this occurs when behaviour is encouraged that meets a target but does not necessarily improve the service to the recipient). It is suggested that such incentives

could arise in the case of a measure of the speed in answering letters that is not balanced by a measure of the quality of responses. Similarly, it is suggested that a target of a number of medical treatments to be provided may encourage medical staff to deal with lots of easy treatments rather than a small number of difficult treatments. The guidance states that avoiding such perverse incentives can be achieved by ensuring that: the measures used fully capture associated objectives and do not omit important dimensions of performance; unwanted activities cannot be legitimately counted under the measures; the measures are well-defined and key terms are sufficiently tight to avoid measured performance being different in nature to that originally envisaged; the measures are relevant to what the organisation is aiming to achieve; and the measures do not encourage unwanted or wasteful behaviour. Overall, in terms of presentation of performance information, the need to make it accessible to its audience is stressed. In particular, issues such as the possibility of using graphs or charts to highlight trends or significant changes in performance, and the provision of contextual information to make sense of performance information, are emphasised.

## **Conclusion**

The importance, and difficulties, of measuring and reporting the performance of charities is highlighted in the previous chapter. This chapter reviews previous research related to the accountability of charities and provides an overview of guidance connected to charity performance reporting. Taken together, chapters two and three help to provide a perspective to understand the empirical work presented later in chapter four. This chapter shows that although performance accountability is viewed as important, there has been limited research into the performance reporting practices of UK charities, and very little guidance as to how to measure and report performance. Previous to this study, what research has been done, which was largely published

in the early 1990s, has highlighted the importance of performance information to contributors to charities and the lack of disclosure of such information by charities. Subsequent to this, while the CAF has prepared guidance specifically linked to their charities' annual report and accounts awards, and some of this guidance relates to measuring and reporting performance, there has been little or no other charity-specific guidance available. Indeed, the CAF guidance itself, while encouraging the publication of performance information, is quite short and limited in providing detailed examples and approaches. Recent performance reporting recommendations relating to charities from government, which is high on broad principles but again short on specific details, may be a harbinger of forthcoming changes that will provide substantial useful guidance to charities. By contrast, in the UK public sector, a diverse sector within which many organisations have similar characteristics to charities, the importance of measuring and reporting performance has been articulated strongly. Good performance measurement and performance reporting systems are viewed as necessary pre-requisites for effective management and appropriate external accountability, two issues that are often considered as being strongly related. In the public sector there has been a plethora of guidance, much of it which could be 'read across' to charities, concerned with such matters as the attributes of performance measures and the design of performance information systems. While much of this guidance acknowledges that performance measurement is a difficult and complex task, and rarely, if ever, will there be a perfect measurement system, it resonates with the belief that well-designed performance measurement and performance reporting systems can lead to more accountable organisations and provide a stimulus for better management. Moreover, evidence suggests that the existence and promotion of such guidance has contributed to the improvement of performance measurement and performance reporting in the UK public sector. Such tailored guidance is not available in the charity sector.

## Endnotes

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- <sup>1</sup> The numerical responses do not use measures that are exact in any numerical sense, but are in effect ranks. Therefore, nonparametric tests are appropriate to test for similarities/differences. The Kruskal-Wallis test is a nonparametric test that tests whether samples are drawn from same/identical or different/non-identical populations. For a detailed explanation, see Siegel (1956).
- <sup>2</sup> It should be noted that the Scottish Council for Voluntary Organisations, in association with the ICAS and Brodies Solicitors, promoted a similar competition, and provided related guidance, for Scottish charities in the mid-1990s.

# CHAPTER FOUR

## CURRENT PRACTICE

It is argued in chapter two that the concept of accountability is inextricably linked with the view that accounting should provide information to satisfy the information needs of users, and that the user-needs model is a useful basis for a conceptual framework for charity reporting. The annual report and financial statements is generally recognised as a key document in the discharge of accountability to external users, and it is suggested that both financial information and performance information should be disclosed to aid the discharge of accountability. This research project, while recognising the importance of traditional financial statements, focuses on information contained in the annual report outside of the financial statements. This includes certain legal and administrative information that the previous charity SORPs have recommended is disclosed in the trustees' report (ASC, 1988; CARC, 1995; Charity Commission, 2000), together with certain quantitative and qualitative performance information. In chapter three, previous research relating to the importance of performance measurement and performance reporting in NFPOs, and in particular in charities, was reviewed. A major thrust of the rather limited and dated previous research in charities was that, although both users and providers of information viewed performance reporting as important, the disclosure of performance information was restricted. With regard to public sector organisations, NFPOs which often possess many similar characteristics to charities, performance reporting has been more substantial and research has suggested that the development of performance measurement and performance reporting systems has

led to a more accountable public sector and has provided a basis for better management.

This chapter presents the results of an empirical analysis of the annual reports of the top 100 UK fundraising charities that identifies the current state of performance reporting by such charities. It seeks to ascertain the extent to which basic background information (for example, related to the legal and administrative arrangements of the charity) and more specific performance information is used in external reporting. Basic background information can be viewed as being important in providing an appropriate context for the understanding of the performance of a charity. In addition, the research attempts to explore whether the extent of reporting of basic background information and performance information has improved in recent years, where improvement is seen in terms of increasing levels of disclosure. The survey focuses on larger charities since they have the highest national profile and are the most significant economically. The next section of this chapter explains the method used in this study and how the sample was gathered and analysed. This is followed by a presentation of the results, which are subsequently analysed and discussed. Examples are provided for illustration purposes.

## **Method**

As a result of prior research (Connolly and Hyndman, 2000), which examined the extent of financial statement compliance with both the original (ASC, 1988) and revised (CARC, 1995) SORPs, the researchers had access to the annual reports of 80 of the top 100 UK fundraising charities for 1996/97 (with requests having been made to all 100 charities). In order to assess whether the reporting of basic background information and performance information has changed over time, and to obtain an up-to-date picture of reporting practices, copies of the 2001/02 annual reports were requested from the same

charities. A similar approach to that used for the collection of the 1996/97 annual reports was adopted with regard to the collection of the 2001/02 annual reports. Letters were sent to the 100 charities requesting copies of their 2001/02 annual reports. Approximately three weeks after the initial request, second requests were mailed to those charities that had failed to respond or had returned inappropriate information (for example, summarised accounts or an annual review). Non-response bias was a potential problem. To test for this, chi-square tests were used to identify whether there were significant differences between early and late responses. Late respondents were used as surrogates for non-respondents (Wallace and Mellor, 1988; Oppenheim, 1992; Babbie, 1998). The results of the analysis of the first respondents (early respondents) were compared with those who returned reports after the second request was mailed (late respondents). No significant difference between the early and late respondents was found.

The response rate to the request for 1996/97 and 2001/02 annual reports is shown in Table 4.1. While 80 charities provided annual reports for the 1996/97 request, the number in 2001/02 was 66. Fifty-eight charities were common to both samples and it is this number that is used for comparison purposes in the tables reported in this chapter (comparisons using the full sample from each of the years are given in appendix three). It is interesting to note that 83 of the top 100 fundraising charities in the list used for the 1996/97 sample remained in the top 100 in the 2002 listing (CAF, 2002), and that all of the 58 charities that provided information for both years (1996/97 and 2001/02) remained in the top 100 in 2002. The total incoming resources of the top 100 fundraising charities in 1996/97 ranged from £144.4 million to £3.3 million and from £251.3 million to £6.6 million in 2001/02.

**Table 4.1 Response Rate to Request for Information**

	1996/97		2001/02	
	No.	%	No.	%
Requests made	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>
Usable responses	80	92	66	93
Unusable responses	7	8	5	7
<b>Total responses</b>	<b>87</b>	<b>100</b>	<b>71</b>	<b>100</b>

A checklist, focusing on information outside of the financial statements, and distinguishing between basic background information and more specific performance information, was designed for use on the annual reports. Points of reference used for the development of the checklist were the recommendations included in the various SORPs, the guidance provided by the CAF (2001) and the information types identified by Hyndman (1990) as being important to contributors. For analysis purposes, information was considered disclosed if it was highlighted in some way (hard copy) and not contained in the main narrative of the annual report (soft copy). The extent to which soft copy information was disclosed is not reported in the tables below since it may be difficult for the user to isolate and use this information as it is often embedded in a mass of subjective comment. In addition, it is sometimes given in a form that may make it difficult for a user to understand its significance. This is not to say that soft copy information is unimportant, but rather that the most effective communications of essential information are likely to be made through its highlighting.

Definitions and rules were also developed (appendix four) for classifying the hard copy information in order to reduce the impact of subjectivity. The rules included: information presented in more

than one way is only counted once (in its most detailed form); when there is an efficiency target and the actual achievement of efficiency is given, this is counted as a measure of efficiency only; and when there is a quality target and the actual achievement of quality is given, this is counted as a measure of effectiveness. This approach ensured that, as far as possible, terms were being used in the same manner for each charity. A particular moot point, and one that was considered at length by the researchers, related to the identification of efficiency measures (defined as ratios measuring the relationship of outputs to inputs, and sometimes expressed as an amount of output per unit of input, a cost per unit of output, a ratio relating overhead costs to total expenses or a ratio relating fundraising costs to total funds raised). A rule used for classification was that if an arithmetic calculation was made, for example dividing administration costs by total costs to give an administration cost percentage, then this was counted as an efficiency measure. However, if total costs and total administration costs were disclosed separately, for example as figures in the operating statement, but not specifically related to one another in an arithmetic calculation (a ratio), this was not included as a measure of efficiency. The analysis was conducted in this manner even though it might be argued that if the overhead costs and total costs were provided as figures within the operating statement (as they were for over 95 per cent of charities in the Connolly and Hyndman (2000) paper), an efficiency ratio could be calculated. However, given the fact that the majority of users of charity accounts, as is the case with the majority of users of commercial accounts, have limited understanding of audited financial statements (Bird and Morgan-Jones, 1981; CICA, 1980b), disclosure within the operating statement as individual figures within a mass of other figures, was not deemed a communication of a measure of efficiency.

## Results

### Basic background information

For external reporting purposes, UK companies are bound by law to produce a set of accounts for publication. This must include a directors' report, and may also include a chairman's statement, which, according to Pendlebury and Groves (1994), should provide a narrative supplement to the financial statements. The directors' report is required to provide information relating to the company's activities during the period under review, its directors and employees, and likely future developments. Pendlebury and Groves claim that such information is an influential part of the annual report and is widely read by shareholders. In the context of charities, the trustees' report fulfils a comparable role to that of the directors' report.

In a similar fashion, and specifically focusing on charities, the CAF (2001) suggests that certain basic background information should be provided at the front of each charity annual report. Like company legislation, this advocates the inclusion of: details as to how the charity is constituted; its aims and objectives; a full list of the trustees and officers of the charity; and an address at which the charity may be contacted. Furthermore, the 1988, 1995 and 2000 SORPs (ASC, 1988; CARC, 1995; Charity Commission, 2000) also recommend that certain legal and administrative information should be included by charities in their annual reports in order to enable the reader to understand better a charity's structure and activities. The 2000 SORP suggests that a report describing what the charity is trying to do and how it is going about it should be provided. It is recommended that, as part of the report, there should be a statement outlining broad background information relating to the charity, including: an indication of the nature of the governing document (*eg* trust deed, memorandum and articles of association, Charity Commission Scheme or Royal Charter); how the charity is

(or its trustees are) constituted (*eg* limited company, unincorporated association or trustees incorporated as a body); the names of all of the charity's trustees (including the officers of the charity); and the address of the principal/registered office of the charity. Furthermore, the SORP recommends that the trustees' report should assist the reader in interpreting the accounts and relating the numerical aspects to the organisational structure and activities.

Table 4.2 highlights the basic background information provided by the top 100 fundraising UK charities in their 1996/97 and 2001/02 annual reports. Seven items of information, drawn from the above discussion, were identified and reported. These were: an indication of the governing instrument; details of how a charity is constituted; review of the year; an explanation of the salient features of the accounts; names of trustees; names of principal officers; and address of principal or registered office. These information types, although not performance information, are viewed as important by the CAF (2001) and the Charity Commission (2000), and provide a context to understanding the performance of a charity. For example, information relating to the governing instrument may outline the broad objects of the charity, how it relates to its external environment and how it is governed internally. Details of how a charity is constituted may indicate the extent to which an organisation is centrally recognised as having provided useful service over many years (as in the case of a charity incorporated by Royal Charter), and therefore may lend credibility to its activities. A review of the year may attempt to explain and interpret the activities of the charity. An explanation of the salient features of the accounts may indicate the degree to which a charity has 'lived within its means' and the extent to which funds are presently available to expand its provision of services. The names of trustees and principal officers of the charity may help to promote confidence in the operations of the charity. Finally, the address of the principal or registered office

provides a contact point for external parties and indicates a willingness to engage in communication.

The numbers and percentages of the 58 'matched' charities providing each of these seven items of basic background information are reported in Table 4.2 (the findings from the analysis of all usable responses are presented in appendix three). Chi-square tests were carried out to identify differences between the 1996/97 and 2001/02 annual reports, and significant differences (at the 1 per cent and 5 per cent levels) are indicated.

**Table 4.2 Basic Background Information**

	Disclosure				Significant difference
	1996/97		2001/02		
<b>Number of annual reports analysed</b>	<i>Matched Replies</i> 58		<i>Matched Replies</i> 58		
<b>Item:</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	
(a) Indication of governing instrument	58	100	58	100	No
(b) Details of how charity constituted	58	100	58	100	No
(c) Review of the year	56	97	56	97	No
(d) Salient features of accounts explained	57	98	57	98	No
(e) Names of trustees	58	100	58	100	No
(f) Names of principal officers	58	100	58	100	No
(g) Address of principal/registered office	58	100	58	100	No

With each of the items of basic background information disclosure was extensive, with no discernable difference in disclosure between 1996/97 and 2001/02. The disclosure of five of the seven items (a) an indication of the governing instrument; (b) details of how a charity is

constituted; (e) names of trustees; (f) names of principal officers; and (g) address of principal or registered office) remained at 100 per cent for both years, while the level of disclosure for items (c) and (d) was 97 per cent and 98 per cent respectively in both years. The analysis of all the charities returning 1996/97 or 2001/02 annual reports (totals of 80 and 66 respectively) shows a similar trend (appendix three, table 1). The Charity Commission prepares guidance to assist trustees and practitioners to apply the recommendations of SORP 2000. Publication *CC66 SORP 2000 Example Reports and Accounts* ([www.charity-commission.gov.uk/publications/cc66.asp](http://www.charity-commission.gov.uk/publications/cc66.asp).) includes a selection of example reports and accounts which follow the SORP's provisions. Examples of each of the seven items of basic background information, based upon example A (Arts Theatre Trust Limited) and example B (Dorsetshire Drugs Advice Centre) in the Charity Commission guidance, are shown in Table 4.3.

**Table 4.3 Basic Background Information: Examples from the Charity Commission**

<b>Item:</b>	
(a) Indication of governing instrument, and	The organisation is a charitable company limited by guarantee, incorporated on 8 August 1992 and registered as a charity on the 8 September 1992. The Company was established under a Memorandum of Association, which established the objects and powers of the charitable company and is governed under its Articles of Association. Under those Articles, the members of the Management Committee are elected at the AGM to serve a period of 3 years, subject to ratification at each AGM.
(b) Details of how charity constituted	

(c) Review of the year	<p><b>Advice and information:</b> This project is based at the central office and provides help and advice to drug users, teachers, social workers and others wanting to know more about the effects of drug use. Several information leaflets have been produced and these are now available in doctors' surgeries <i>etc, etc.</i></p> <p><b>Outreach work:</b> The work of the charity of reaching out to young people who are vulnerable or falling into drug misuse continued to expand in the year under review. At the beginning of the year, we had set a target to reach 150 new people and to make our other services available to them. We did not manage to reach our target as we had some difficulty in recruiting staff <i>etc, etc.</i></p> <p><b>Training project:</b> The contract with Dorsetshire County Council to run a café in the centre of Dorchester continues to run successfully. All the staff working in the café are former drug users training in catering <i>etc, etc.</i></p>
(d) Salient features of accounts explained	<p>The end of the year saw an excellent financial result based on strong financial management. Costs were contained within budget and income budgets were exceeded in both the arts and trading areas. Incoming resources exceeded resources expended in the year ending 31 March 2001 by £78,000 (2000-£27,000) <i>etc, etc.</i></p>

<p>(e) Names of trustees, and</p> <p>(f) Names of principal officers</p>	<p>The directors of the charitable company (“the charity”) are its trustees for the purpose of charity law and throughout this report are collectively referred to as the trustees. As set out in the Articles of Association the chairman of the trustees is nominated by N Arts, BF Borough Council nominates five trustees and B Town Council nominates three trustees. Two trustees are elected annually by the members of the charitable company attending the Annual General Meeting and serve for a period of two years. These trustees have the power to co-opt up to two further members to fill specialist roles. The trustees serving during the year and since the year-end were as follows:</p> <p>Mr P Smith, Chair  Mrs M Haliwell, Treasurer  Mr T Forester (resigned 11 November 2001)  Mr G Peterson (appointed 22 October 2001)  <i>etc, etc.</i></p>
<p>(g) Address of registered office</p>	<p>Registered office and operating address:  ATC Park, Anytown, Berkshire, BX56 7SG</p>

## Performance information

As was discussed in chapter two, the disclosure of performance information is important in discharging the accountability of charities. As was seen, a number of studies of performance in the wider not-for-profit sector have modelled performance in terms of a production model consisting of three stages (inputs, outputs and results), with performance being judged in terms of efficiency and effectiveness (Brace *et al.* 1980; AAA, 1989; HM Treasury, 2001). The empirical investigation by Hyndman (1990) provided evidence that users of

charity reports viewed performance information as paramount in meeting their information needs. As a conclusion to the study it was suggested that a model of reporting be adopted by charities, with the model focusing heavily on the reporting of performance information. Essential performance-related aspects of this model, modified slightly to reflect the earlier discussion on performance information and some later reflections by the model's originator (Hyndman and McKillop, 1999), are used to capture aspects of the reporting of performance by charities in this study. Table 4.4 focuses on the disclosure of selected performance information by charities in 1996/97 and 2001/02. Eight items of performance information, based on the discussion included in chapter two, were identified and reported. These were: goals and objectives; inputs; outputs; results; efficiency (including administration cost percentage information); effectiveness; future target information; and budget information

Goals are defined as intended outputs in broad terms, whereas objectives are specific, measurable targets to be achieved within a particular time frame (Anthony and Young, 1999). In a co-ordinated system of planning, objectives should be in harmony with the goals of the organisation. Objectives are essential in measuring the effectiveness of the organisation, where actual outputs (or results) are compared with objectives. As was highlighted earlier, most studies of performance in the not-for-profit sector have modelled performance in terms of a production model consisting of three stages (inputs, outputs and results) and it is suggested that the capturing of information at these stages is necessary to measure both efficiency and effectiveness. Using a similar model in relation to public sector organisations, Hyndman and Anderson (1998) argued that while the component parts of performance (*ie* inputs, outputs and results) may be useful in gaining some insight into performance, the higher measures of performance (*ie* efficiency and effectiveness) are more critical. While a measure of efficiency normally relates the inputs (financial or non-financial) to outputs (or

results), an alternative, or supplementary, indicator of efficiency could be developed by relating administration costs to total expenditure, a performance information type that is viewed by contributors as being of considerable importance (Hyndman, 1990). Overall, with regard to efficiency and effectiveness measures in charities, Bird and Morgan-Jones (1981) expressed the view that such information is needed in assessing how resources have been used in meeting the needs of beneficiaries. The extent to which these performance information items, many of which were included in the Hyndman (1990) model, are disclosed by charities is disclosed in Table 4.4.

While the above information items focus on present or past performance, the CICA (1980b) and Bird and Morgan-Jones (1981) contend that performance information relating to what a charity intends to do in the future is also important. For example, this information would be useful for those deciding whether or not to fund, or continue to fund, a charity's activities. Such information could include a statement of future objectives or targets, which may be an expression of planned future output, possibly covering the next year. As discussed above, this would permit future performance to be compared with information on planned performance that had been published earlier. Furthermore, it may be useful to outline overall plans in terms of a financial budget. Such information would provide an indication of revenue requirements for the ensuing period. Indeed, Anthony and Young (1999) consider the preparation of a budget for an NFPO as being more important than for a business enterprise. This is because, in an NFPO, a larger proportion of expenditures is discretionary and the conditions affecting the operation of an NFPO are more predictable. Both of these future oriented performance information items are disclosed in Table 4.4. As in the case of basic background information, the numbers and percentages of charities providing each of the eight items of selected performance information are reported in Table 4.4. As before, chi-square tests were carried

out to identify differences between the 1996/97 and 2001/02 annual reports, and significant differences (at the 1 per cent and 5 per cent levels) are indicated.

**Table 4.4 Selected Performance Information**

	Disclosure				Significant Difference
	1996/97		2001/02		1996/97 v 2001/02
<b>Number of annual reports analysed</b>	<i>Matched Replies</i> 58		<i>Matched Replies</i> 58		
Item:	No	%	No	%	Matched Replies
(h) Goals and objectives	58	100	57	98	No
(i) Inputs	49	85	51	88	No
(j) Outputs	56	97	53	91	No
(k) Results	54	93	51	88	No
(l) Efficiency	2	3	5	9	No
(m) Effectiveness	40	69	17	29	1%
(n) Future target information	4	7	8	14	No
(o) Budget information	15	26	3	5	1%

As can be seen in Table 4.4, there was substantial disclosure (over 80 per cent of charities) with four of the eight performance information items in both 1996/97 and 2001/02 (h) goals and objectives; (i) inputs; (j) outputs; and (k) results). However, the level of disclosure in 2001/02,

compared with 1996/97, for three of these four items (items i, j and k) fell slightly, although in no case was the change statistically significant at normal levels. For example, in the case of measures of output, 97 per cent of the 1996/97 annual reports contained at least one item of information, compared with 91 per cent of the 2001/02 reports. The most marked change was with regard to measures of effectiveness (item m). Although item (m) showed fairly substantial disclosure (69 per cent) in 1996/97, this fell to 29 per cent in 2001/02, a difference that is significant at the 1 per cent level. With regard to the remaining three information types (l) efficiency; (n) future target information; and (o) budget information) disclosure was not extensive (less than 26 per cent) in either period, albeit that the level of disclosure with regard to items l and n did increase slightly over the period. In contrast, the disclosure of budget information (item (o)) fell from 26 per cent to 5 per cent, a difference that is significant at the 1 per cent level. Examples of each of the eight items of performance information identified in the research, shown by the charity making the disclosure, are included in Table 4.5 (goals and objectives, inputs, outputs and results) and Table 4.6 (efficiency, effectiveness, future target information and budget information). As with the background information, similar trends are found when all the 80 charities returning 1996/97 annual reports and all the 66 charities returning 2001/02 annual reports are included in the analysis (see appendix three, table 2).

**Table 4.5 Examples of Goals and Objectives, Inputs, Outputs and Results (Charity Annual Reports)**

<b>Goals and objectives- information item (h)</b>	
<b>Example</b>	<b>Charity</b>
The advancement of the Christian religion and pursuant thereto, the advancement of education, the relief of poverty and other charitable objects beneficial to society or the community of mankind as a whole.	Salvation Army
The objects of the Society are to promote kindness and to prevent or suppress cruelty to animals and to do all such lawful acts as the Society may consider to be conducive or incidental to the attainment of those objects.	RSPCA
<b>Inputs- information item (i)</b>	
<b>Example</b>	<b>Charity</b>
Pie charts showing percentage spend by region and by aim.	Oxfam
Analysis of total expenditure of £90,639,000: AFRICA £52,073,000 Angola £4,277,000 – Advocacy on children’s rights, social policy and child participation legislation; tackling urban childhood poverty by micro-finance schemes ... (then other African countries’ expenditure and purpose of expenditure provided).	Save the Children

**Table 4.5 Examples of Goals and Objectives, Inputs, Outputs and Results (Charity Annual Reports) (Continued)**

<b>Outputs- information item (j)</b>	
<b>Example</b>	<b>Charity</b>
<p>There was a steady demand for all our UK services last year with growth in several areas:            Help with transport: 122,257 journeys (+18% compared with 2000)            Domiciliary care: 134,125 visits (-15%)            Message &amp; tracing: 1,543 completed cases (+1%)            Refugee &amp; asylum seekers: 19,194 using our services (+59%)            Fire victim support: 1,328 call outs (-9%)            First aid services: 17,082 events covered (-14%)            Medical loans: 214,185 loans of medical equipment (+12.5%)</p>	British Red Cross
<p>Student Support Network: helped 1,100 people to get a job.            Benefit Rights and Information Team: gave individual help to nearly 8,000 people, mainly pensioners.</p>	Royal National Institute for the Blind

**Table 4.5 Examples of Goals and Objectives, Inputs, Outputs and Results (Charity Annual Reports) (Continued)**

<b>Results- information item (k)</b>	
<b>Example</b>	<b>Charity</b>
<p>Numerous personal stories:            “My first call to ChildLine made me realise that there are people who care and want to make things better – and that I could do something to make it better too. I’ve been ringing regularly for the last four years and ChildLine has kept me going and really, really supported me. They never judged me about what went on.”            “I really wanted to say thank you to ChildLine for helping me while I was growing up. If it wasn’t for ChildLine’s help, I don’t think I’d be alive now.”</p>	ChildLine
<p>The prevalence of blindness has decreased by over 50% in areas where the programme has been running.</p>	Sight Savers International

**Table 4.6 Examples of Efficiency, Effectiveness, Future Target Information and Budget Information (Charity Annual Reports)**

<b>Efficiency- information item (l)</b>	
<b>Example</b>	<b>Charity</b>
<ul style="list-style-type: none"> <li>Diagram (including coins) stating: from every £1 you give us ... we spend 78p on direct charitable expenditure to benefit children ... with the remaining 22p ... we go out and raise another £1.</li> </ul>	Save the Children
<ul style="list-style-type: none"> <li>Diagram illustrating income raised and how it was spent and utilised, including calculation of ratio of fundraising cost as a proportion of fundraising income (24%).</li> </ul>	Help the Aged
<b>Effectiveness- information item (m)</b>	
<b>Example</b>	<b>Charity</b>
<ul style="list-style-type: none"> <li><u>Target</u>: to conduct six audits of the quality of residential services. <u>Actual</u>: Achieved.</li> </ul>	SENSE
<ul style="list-style-type: none"> <li><u>Target</u>: to reach a fundraising total of £3.533 million (in addition to designated solicited incoming resources) <u>Actual</u>: £3.660 million raised</li> </ul>	Royal Air Forces Association

**Table 4.6 Examples of Efficiency, Effectiveness, Future Target Information and Budget Information (Charity Annual Reports) (Continued)**

<i>Future target information- information item (n)</i>	
<b>Example</b>	<b>Charity</b>
<ul style="list-style-type: none"> <li>The Governors have approved a development programme which will be implemented over the next three years and which will include the building of a 40-bed dementia unit.</li> </ul>	The Royal Star and Garter Home for Disabled Sailors, Soldiers and Airmen
<ul style="list-style-type: none"> <li>In the year ahead, we shall: Restructure our SeniorLine to respond to an additional 100,000 enquiries, helping yet more people claim the benefits due to them. Launch ten new HandyVan projects and secure a further 15,000 homes. Set up six medical research fellowships with Research into Ageing to advance the prevention and treatment of illnesses and disabilities that can become more common in older age.</li> </ul>	Help the Aged
<i>Budget information- information item (o)</i>	
<b>Example</b>	<b>Charity</b>
<ul style="list-style-type: none"> <li>Details of budgeted expenditure based upon grants pledged over the next three years. For example: £151,920 (including running costs) for three years to be paid to Circles Network for the salary of a lead facilitator for the children's project working with children at risk of isolation through disability or illness.</li> </ul>	BBC Children in Need

**Table 4.6** *Examples of Efficiency, Effectiveness, Future Target Information and Budget Information (Charity Annual Reports) (Continued)*

<i>Budget information- information item (o)</i>	
<b>Example</b>	<b>Charity</b>
<ul style="list-style-type: none"> <li>Budget information for the coming year: provide grants of more than £4 million for 150 research projects.</li> </ul>	Association for International Cancer Research

## **Analysis and discussion**

Throughout this research report it has been argued that charities have an accountability to those outside their immediate management, and that the annual report is an important medium through which this accountability can be discharged. It is further argued that while the information disclosed in the financial statements may be of importance, other wider information, particularly relating to performance, is paramount in discharging accountability. Overall, the research seeks to ascertain the extent to which performance accountability is discharged through the medium of the annual report. Specifically, the empirical study reported in this research report has as its objective the analysis of recent annual reports of the top 100 UK fundraising charities to ascertain the extent to which basic background information and more specific performance information is used in external reporting.

### **Basic background information**

The research distinguished between the reporting of basic background information, seen as important in providing an appropriate context to the understanding of the performance of a charity, and performance information. With regard to the former, the disclosure of the seven items of basic background information (Table 4.2) is consistently high. Disclosure of each of the items in both 1996/97 and 2001/02 ranged from a low of 97 per cent (item c) to a high of 100 per cent (items a, b, e, f and g). This would suggest that most users of annual reports have access to basic background information

that may be useful in providing a context to the understanding and interpretation of any performance information.

### Performance information

The disclosure of the eight performance information items (Table 4.4) was considerably lower than the basic background information (Table 4.2). For illustration purposes, the disclosure of the performance information items across all charities in 1996/97 and 2001/02 is summarised in Table 4.7, with comparable results from the Hyndman (1990) study shown (where comparisons can be made), so as to highlight areas where disclosure may have changed over time. Comparisons of the entire sample of 1996/97 and 2001/02 annual reports (80 from 1996/97 and 66 from 2001/02) are shown in appendix three. The pattern is very similar.

**Table 4.7 Summary of Results of Selected Performance Information**

	<i>Hyndman, 1990</i>		<i>This Study</i>			
			1996/97		2001/02	
<b>Number of annual reports analysed:</b>	<b>163</b>		<b>58</b>		<b>58</b>	
<b>Item:</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>
(h) Goals and objectives	62	38	58	100	57	98
(i) Inputs			49	85	51	88
(j) Outputs	47	29	56	97	53	91
(k) Results			54	93	51	88
(l) Efficiency	35	21	2	3	5	9
(m) Effectiveness			40	69	17	29
(n) Future target information	1	1	4	7	8	14
(o) Budget information	8	5	15	26	3	5

The key issues arising from the analysis of the performance information are discussed under the themes of: discharge of accountability; changes over time and comparisons with other studies; charity awareness and willingness; and window dressing.

### Discharge of accountability

It has been argued earlier that performance information, and particularly that related to the measurement of efficiency and effectiveness, was important in meeting the information needs of users of charity reports, an aspect of discharging accountability.

Indeed, empirical evidence provided by Hyndman (1990) showed this to be the case with regard to contributors to charities. Similar sentiments could be expressed in relation to a large spectrum of NFPOs. Nevertheless, it is acknowledged, and discussed at length in chapter two, that developing performance measurement systems and reporting performance information is fraught with problems. In particular, with some charities the ultimate performance, or outcome, that is being sought may be impossible to measure, possibly because of its intangible nature, the time horizon over which it occurs or the impact which factors unrelated to the activity of the charity may have. However, it is mainly because of these difficulties that guidance and models of reporting have been developed in other not-for-profit sectors. In this research report, reference has been particularly focused on post-1990 UK public sector guidance, a sector with many similarities to the charity sector. In such guidance, the major difficulty of approximating anything like perfect measures is stressed, but it is suggested that well thought out and well-developed measurement and reporting systems can both improve accountability and provide a useful basis for managing the organisation.

With regard to performance reporting by charities, it can be seen in Table 4.7 that the disclosure of the eight items of performance information in 2001/02 ranged from 98 per cent (item (h)- goals and objectives) to 5 per cent (item (o) budget information). As discussed in chapter two, the main objective of accounting and accountability can be viewed in terms of fulfilling users' information needs. Many of the external users of charity annual reports normally have no direct powers of interrogation and therefore must rely on such reports to meet their information needs. The Hyndman (1990) study identified performance information as critical in meeting the information needs of users of charity reports, and the empirical research reported in this research report utilises the Hyndman results as a point of reference. Even after acknowledging the potential difficulties of measuring

performance in a charity, when the results of the Hyndman study are combined with the results in this research, it is suggested that extant charity reports do not meet the most important information needs of users and therefore the relevance of such reporting can be questioned. For example, the Hyndman study found that users of charity reports viewed measures of efficiency as extremely important information. However, this study reports that only 9 per cent of charities in 2001/02 provided such information. Similarly, with regard to effectiveness (another information type identified as important in the Hyndman research), this study reports that only 29 per cent of charities in 2001/02 provided such information. Each of these disclosures (efficiency and effectiveness information) is supported strongly by Bird and Morgan-Jones (1981) and the CICA (1980b). Such lack of accountability could disadvantage users of charity reports. It can be argued that efficiency and effectiveness information is required by users to make judgements and decisions that impact on economic and social well-being by providing a visibility to the resources, activities and achievements of an organisation (thus enabling informed discussions and decisions).

With regard to efficiency information in particular, Callen and Falk (1993, p.50) argued that large contributors would be interested because:

*... there is probably little return from association with an inefficient, wasteful charity, especially if such wastefulness becomes known to the public at large. This concern motivates large donors to monitor the charity's efficient use of resources.*

Similar sentiments were expressed by Bird and Morgan-Jones (1981, p.133) in the context of all contributors, where it was suggested that individuals 'tend to give to charities which they are satisfied are doing the work they wish to assist and are spending the money that is given to them effectively ... rather than wasting it'. Such scenarios suggest, for example, that the publication of efficiency information by

a charity (in cases where the charity has operated efficiently) may well increase its attraction to potential contributors. Conversely, information indicative of poor efficiency, or no efficiency information at all, may well dissuade potential contributors. Similar arguments could be made in the case of other performance information. A lack of adequate performance accountability, particularly if it were highlighted in the media, could discourage potential donors. Overall, the findings in the research reported in this report suggest that charities do not adequately discharge their accountability for performance.

### Changes over time and comparisons with other studies

A comparison of this study with the Hyndman (1990) study provides some limited insights into how performance reporting by charities has changed over time. Although the two studies are not directly comparable, five of the eight performance-related items analysed in this study were also analysed in the earlier Hyndman study. Based upon the information shown in Table 4.7, the Hyndman (1990) study found an average level of disclosure of 19 per cent among the five items of performance information disclosed in Table 4.7. This research indicates that the average disclosure for the same five items was 47 per cent in 1996/97 and 43 per cent in 2001/02. In particular, the reporting of item (h) goals and objectives and item (j) outputs increased significantly from the earlier study. The two information types were disclosed by 38 per cent and 29 per cent of charities in the Hyndman (1990) study, but over 90 per cent of charities in the two time periods captured in this study. Such improvement overall in the reporting of performance information, while possibly being welcomed, is from a rather limited initial point of comparison. A possible explanation for this improvement may have been the increasing articulation of the importance of performance reporting by the CAF, evidenced by their promotion of the *Charities Published Accounts Awards* and the related

guidance provided (CAF, 2001). However, such improvements may not apply to all charities as this research deals with large charities that are most likely to be involved in high profile award competitions of this nature. Other possible reasons for improvement may be the influence of practices in the public sector, where performance-reporting systems have developed more strongly, and the increasing profile of such techniques as the Balanced Scorecard (Kaplan and Norton, 1996), especially in the private sector.

However, the changes in the reporting of performance information over time are not consistent over all aspects of performance reporting. The earlier Hyndman (1990) study showed much greater reporting of efficiency information (21 per cent) than the later annual reports. Only 3 per cent of the 1996/97 annual reports contained such information. While it is impossible to be certain as to a reason for this, possibly it was caused by the increasing sensitivity of charities to publishing information of this type (see below under 'window dressing' for a fuller discussion). This is despite the fact that efficiency information is viewed as important by users, and known, by providers of information, to be important to users (Hyndman, 1991). The most striking, and surprising, difference between the 1996/97 annual reports and the 2001/02 sample is the major reduction in the reporting of measures of effectiveness. Sixty-nine per cent of the earlier reports have at least one measure of effectiveness compared with only 29 per cent of the 2001/02 reports. A detailed examination of the matched annual reports of several charities, 1996/97 compared with 2001/02, showed that there was a tendency to reduce the reporting of specific effectiveness information in the 2001/02 reports and increase the reporting of more 'marketing-focused' information. There was clear evidence of much glossier presentations and the increasing use of photographs in the later reports. For example, the British and Foreign Bible Society, which had a number of measures of effectiveness in their 1996/97 annual report and no photographs, had no measures of effectiveness in their

2001/02 annual report and photographs on every page of the annual report. Other examples of this trend are seen with the annual reports of the Multiple Sclerosis Society and Age Concern, with the 2001/02 annual reports of each of these being much glossier, containing many more photographs while reducing or eliminating specific effectiveness measures in comparison with their 1996/97 reports. Overall, while some increase in the reporting of performance information from 1990 is evident, there is no clear and unambiguous increase in the reporting of efficiency and effectiveness information (possibly the most important performance information sought by users). In addition, the fluctuations in reporting year-on-year may, in part, be influenced by the lack of a template for the reporting of charity performance (even though, because of the diverse nature of the sector, such would have to be fairly general) and the rather limited charity-specific guidance available.

A comparison of this study with other studies in the wider not-for-profit sector shows that, generally, this lack of disclosure of performance information is pervasive (Brace *et al*, 1980; Thompson, 1995; Hyndman, McKillop, Ferguson and Wall, 2001). However, as was reviewed in chapter three, it is interesting to note that in the UK public sector, where there has been clear articulation from high levels in government of the need to develop appropriate performance measurement and performance reporting systems, the measuring and reporting of performance has improved significantly over time. This has been viewed as beneficial in terms of accountability and in terms of developing more efficient and effective organisations (Hyndman and Anderson, 1998; Karbhari and Pendlebury, 1997; Hyndman and Eden, 2001).

Over ten years have elapsed since the Hyndman (1990) study which identified that charities' annual reports were deficient in meeting the information needs of users and that greater disclosure of performance information was needed to improve the situation. While there has been some limited increase in performance reporting through

the medium of the annual report since that time, progress has been slow. Given that developments in the public sector with regard to performance reporting have been more considerable, possibly facilitated by a more proactive central support function and greater prescription (Hyndman and Anderson, 1998), the change in charity reporting is perhaps disappointing. While some effort has been made to highlight the need for charities to disclose more performance information (CAF, 2001), the concentration on specific guidance has been on financial accounting matters (ASC, 1988; CARC, 1995; Charity Commission, 2000), information that was identified by Hyndman (1990) as being considerably less relevant to users of charity reports than performance information. Indeed, it could be argued that this focus on financial accounting matters may have detracted from a meaningful debate relating to the relevance of the information content of charity annual reports.

### Charity awareness and willingness

It is possible that such limited performance reporting could result from charities being unaware of the information needs of users or, alternatively, from charities being unwilling to disclose many of the items. As was seen in chapter three, Hyndman (1991) shows clearly that providers of charity reports are very aware of the dominant information needs of users of charity reports and are conscious of the relevance of performance information to such parties. With regard to unwillingness to disclose, there could be a number of reasons for this. For example, as was suggested in the previous discussion regarding the decline in the reporting of efficiency information, charities may be satisfied with existing reporting procedures or they may fear that such information would be misinterpreted. Furthermore, as with all cases of information provision, charities may view that the cost of providing such information is disproportionately high compared

with the benefit received. It could be argued that the provision of performance information, which is voluntary, imposes costs on a charity, and the lack of disclosure is indicative of an efficient charity. However, such an argument ignores important reasons for disclosing such information, some of which are related to economic incentives from disclosure. In terms of businesses, voluntary disclosure above and beyond regulatory requirements is often viewed as having a significant impact on an organisation's financial success, particularly in terms of reducing the costs of finance and improving the access to financial markets (FASB, 2001). A number of studies have suggested that there are major market incentives to disclose information voluntarily, although managers' attitudes to the perceived costs and benefits of such disclosure are important (Gray, Radebaugh and Roberts, 1990; Healy and Palepu, 1995). Ignoring accountability issues, it could be argued that in an environment where charities compete for contributions, the voluntary disclosure of performance information, possibly emphasising past performance and future plans, may enhance its attractiveness to existing and potential donors.

Whether all or any of these reasons justify non-disclosure is debatable. A more probable reason for non-disclosure may be a general complacency with existing reporting practices, since it is difficult to understand why, for example, a statement on the future targets would be omitted on the grounds of cost or that it might be misinterpreted. Related to the above in terms of economic impact, is that while it may be of some concern that charities do not include significant amounts of performance information in their annual reports, what may be of greater concern is that this possibly indicates that such information is unavailable in the internal/management accounting system. A similar argument was made by Gray (1983) with regard to the wider not-for-profit sector, and is alluded to by Wise (1995) in relation to the charity sector.

It has been suggested that the need to discharge accountability through the publication of performance information acts as a disciplining pressure and encourages management to concentrate on the issues that are of importance to those stakeholders who are outside the immediate management of the organisation and often provide the resources for the organisation to function. Without pressure being brought to bear to discharge accountability through the disclosure of performance information, it has been argued that this can lead to managers of charities pursuing their own goals at the expense of the goals of the donors or the stated goals of the charity (Williams, 1984, p.11). In this case, it was suggested that:

*Managers of charities whose private goals are not in accord with those that donors would prefer management to have, may take comfort from this displayed lack of interest in non-reporting ... There may ... be little incentive for management to develop meaningful accounting and reporting systems, or to devise appropriate methods of internal control.*

Similarly, Eden and Hyndman (1999), in reviewing the benefits and difficulties of reporting performance information in a public sector context, argue that while a lack of disclosure may suit some managers, the external pressure provided by the provision of performance information encourages a focus for the organisation and provides a catalyst for managers as they seek to improve performance. Making a comparable point, but in a more negative tone, Fox (1992) states that although accountability is viewed as desirable, empirical investigation commonly indicates that both leaders and subordinates in public and private organisations seek to avoid accountability.

A more extreme version of the above argument suggests that in NFPOs with limited performance measurement and performance reporting, and weak forms of accountability, there may be no incentive to manage efficiently, and managerial shirking will result (Hansmann,

1996). With regard to charities, it could be argued that any cost savings in terms of less extensive disclosure (as previously intimated may perhaps be the case) might be more than eliminated because of less efficient management (and managerial shirking) caused by a lack of discipline and focus in the absence of performance measurement and performance reporting systems. Indeed, recent research into the views of chief executives in public sector organisations provides evidence that the development and use of performance measurement and reporting systems (often at significant cost) can provide major benefits to many stakeholders, including the organisation itself, its clients and those who provide funding, and lead to a more effective and efficient organisation (Hyndman and Eden, 2001).

### Window dressing

Building on previous discussions, it is interesting to note that with regard to the reporting of efficiency (item (l) table 4.7) disclosure decreased from 1990 to 2001/02, from 21 per cent to 9 per cent. Efficiency measures, particularly those relating administration costs to total costs (which are captured as measures of efficiency in this study), are often perceived as potentially damaging headline figures. Beattie and Jones (1994, p.221) have argued that charities may 'have incentives to minimise or de-emphasise their administration expenses *vis-à-vis* their charitable expenditures'. This possibly encouraged charities to engage in 'gaming' by the rather judgemental classification of certain expenditures, often inconsistently, frequently resulting in an understatement of the administration cost percentage. Such behaviour made it difficult to gain an accurate impression of the efficiency of charities, something commented on by a number of writers over 20 years ago (Austin and Posnett, 1979; Bird and Morgan-Jones, 1981). This matter attracted attention in the original SORP (ASC, 1988) and its subsequent revisions (CARC, 1995 and Charity Commission,

2000), and led to much greater prescription regarding classification. Given this scenario, and given the potentially sensitive nature of such a disclosure, this may have resulted in charities being more hesitant to publish such headline information, although, as discussed previously, the more determined and experienced user may well be able to extract such information from the financial statements.

An important issue relating to the publication of performance information, and one which is described by Pendlebury, Jones and Karbhari (1994, p.45) in the context of public sector organisations as ‘the most significant technical problem’, is that of the reliability of externally reported performance information. If no verification of the performance numbers reported by a charity is required, then there may be a temptation to present performance in a manner that is perceived as more acceptable to the reader, for example by exaggerating good performance, regardless of its accuracy. Although, here again, cost/benefit issues need to be considered, given that external parties may use externally reported performance information to make judgements and decisions regarding a charity, then there appears to be a case for some degree of independent verification. Mayston (1985), for example, has argued for bringing to bear similar disciplines on the external reporting of performance measures that are imposed on financial accounting information, *ie* disclosure requirements, external auditing and standard setting after consultation with interested parties. It should be noted that the performance information analysed in this study had not been subject to independent verification, as is the case with performance information reported by the vast majority of NFPOs. This issue has been discussed in the context of the public sector organisations with a suggestion being made that UK public sector organisations should aim to achieve ‘independent validation’ of performance information (Public Accounts Committee, 1997, p.vii), although developments to date have been limited. A fuller discussion of the issue in a public sector context is contained in Likierman (1997). Perhaps unsurprisingly,

given the limited disclosure of performance information identified in this study, there has been no significant debate regarding this issue in the charity sector.

## **Conclusion**

This chapter presents the results of an empirical analysis of the performance-related information in the annual reports of large UK charities. Previous charity accounting research has indicated that performance information has high importance to users of charity accounts, is recognised as having importance to users by providers of information, but is not widely disclosed by charities. The research presented in this report analyses a matched sample of large UK charities over two reporting periods, 1996/97 and 2001/02. The main findings were: charities provide substantial background information that, although not performance information, provides a context to understanding performance; charities disclose limited amounts of performance information and therefore do not adequately meet the information needs of users; and, while there has been some limited improvement in performance reporting since the early 1990s, the reporting of key efficiency and effectiveness information is still quite restricted.

Throughout this research report, the difficulties of developing useful performance measurement and performance reporting systems by charities have been stressed. While these difficulties may provide some explanation of limited reporting, it is likely that other factors have also had a major impact. Indeed, within the public sector, where similar difficulties are present, performance measurement and performance reporting systems are significantly more developed. A number of issues, including the desire or willingness of charities to report, the cost of reporting, possible repercussions of the highlighting of poor performance, the desire to show the charity up in as favourable a light

as possible, and incentives to disclose, are all discussed. It is argued that this lack of disclosure undermines accountability. In addition, lack of external reporting suggests that performance information is unavailable to management in the internal/management accounting system, and this can weaken their ability to plan and control effectively. Moreover, it has been argued by some writers that managers in both public and private organisations may prefer limited performance reporting because they seek to avoid accountability. While some of these arguments ignore the commitment and professionalism of managers in the charity sector, they do provide a persuasive case for the development and use of more substantial performance measurement and performance reporting systems by charities. To encourage such change, and thereby more fittingly meet the information needs of users, it would seem appropriate that focused guidance relating to performance information be provided by those involved in the administration and control of the charity sector. This may include the Charity Commission in England and Wales, the CAF and the Scottish Charities Office. A useful starting point for the provision of charity-focused guidance may be the UK public sector guidance previously highlighted in chapter three. In addition, the recent performance reporting recommendations included in the review of charities published by the UK government (Cabinet Office, 2002), and outlined in chapter three, may provide a necessary catalyst for the provision of appropriate guidance. To expect individual charities to develop meaningful and extensive performance reporting systems without guidance is perhaps overly optimistic. However, without such guidance, and without encouragement to improve performance measurement and performance reporting, this sector may remain weak in accountability and wasteful in terms of the use of limited resources.

# CHAPTER FIVE

## CONCLUSIONS

This chapter reviews the objectives of the research and some of the key themes with regard to charities and performance accountability. Although more detailed conclusions are presented at the end of chapters two to four, a summary of the main findings is provided here.

### **Objectives of the research**

While any discussion of the charity sector in the UK is problematical in terms of drawing a boundary (Pharoah, 1998), it is clear that such a sector is large and growing. Growth in the size and influence of the charity sector has led to increased visibility and public scrutiny by diverse stakeholders including government oversight agencies, private donors and foundations, clients, the media and the public at large. The focus of the empirical research presented in this report is on large UK charities that have the highest national profile and are the most significant economically. Indeed, the top 100 UK fundraising charities reported a total income in 2001/02 of over £3.8 billion, with individual charity incomes ranging from £251.3 million (National Trust) to £6.6 million (British Tennis Foundation) (CAF, 2002).

In this research report it is argued that charities have an accountability to those outside their immediate management, and that the annual report is an important medium through which this accountability can be discharged. Accountability has been defined as 'being obliged to explain one's actions, to justify what has been done' (GASB, 1987, p.21). In considering the accountability of charities, two

key questions emerge: to whom is a charity accountable, and what form should that account take? Within this research report it is suggested that external users, particularly contributors to charities, have legitimate information needs and must primarily rely on the annual report to meet those needs. Moreover, it is argued that while information disclosed in the financial statements may be of importance, other wider information, particularly relating to performance, is paramount in discharging accountability. Overall, the empirical aspect of the research seeks to ascertain the current state of performance reporting by charities *via* the medium of the annual report.

The main objectives of this research are:

1. to review the importance of, and difficulties of, using performance information in the external reports of charities;
2. to examine previous research related to the accountability of charities and provide an overview of guidance connected to performance reporting that may be useful to charities; and
3. to conduct an empirical analysis of the annual reports of the top 100 UK fundraising charities in order to ascertain the extent to which basic background information, and more specific performance information, is used in external reporting.

## **Accounting, accountability and performance information**

Contributors to charities, who are viewed as particularly important users of charity accounting information, and other external parties have information needs, yet, because they are not involved in the management of a charity, must primarily rely on the annual report to meet those information needs. These users are akin to what *The Corporate Report* (1975, p.9) describes as ‘that larger class of general users to whom a responsibility to report is owed and who are not in a privileged position to enforce special demands’. Information provided to them *via* the annual report may be important as they make decisions

and judgements relating to their involvement with the charity. In particular, with regard to contributors, this may relate to decisions regarding the provision of resources, often when there is no direct economic benefit to the contributor.

While accountability, in its widest sense, is more than accounting (however widely accounting is defined), focusing on the information needs of users (a key aspect of a contemporary definition of accounting) seems clearly linked with ideas relating to accountability. Accountability involves explaining what has been, or is being, done and what has been planned. However, this concept is multifaceted. For example, Stewart (1984) identifies a number of different bases of accountability: accountability for probity and legality; process accountability; performance accountability; programme accountability; and policy accountability. Overall, Stewart argues that an accountability information system should report on all levels of accountability, providing financial information and also output and outcome information. In terms of contributors, this report argues that two main types of information are particularly important in discharging accountability: financial information as contained in traditional financial statements; and wider performance information, often of a non-financial nature, especially relating to the efficiency and effectiveness of the charity. The importance of charities measuring and reporting on performance, which is a very different issue from a business measuring and reporting performance, has been recognised in a number of NFPO publications. It is argued that the inclusion of performance information in annual reports of charities will lead to a more accountable charitable sector and also provide a stimulus for better management within a charity.

While recognising the importance of charities developing appropriate performance measurement and performance reporting systems, it is acknowledged that many difficulties confront those tasked with developing an information system that provides such measures.

These include: setting clear goals and objectives; avoiding a ritualistic approach where the process of setting objectives and reporting performance degenerates into a formal ceremony with little impact on behaviour; ensuring that the information is reliable; dealing with the complexity of organisations; ensuring that quality, as well as quantity, is measured; making meaningful comparisons between measures; and co-ordinating measures so that the low-level measures help to motivate individuals to behave in a way that furthers the overall strategic mission of the organisation. An awareness of these difficulties may help to focus attention on some of the important issues to be addressed by the system designer, and support the development of appropriate and well-balanced performance measurement systems.

### **Previous research and recent guidance**

Although performance accountability is viewed as important, there has been limited research into the performance reporting practices of UK charities. Indeed, earlier research on the accountability of charities has focused on financial accountability, where it is argued that the quality of financial statements can be judged in terms of their compliance with the extant SORP (or generally accepted accounting principles). Overall, these studies have shown that the impact of SORPs has been significant with large charities, somewhat limited in the case of small charities, and lagged (that is to say, if adopted, not immediately adopted) with most charities, regardless of size.

Previous to this study, what research has been done with regard to the performance accountability of charities, which was largely published in the early 1990s, has illustrated the importance of performance information to contributors to charities and the lack of disclosure of such information by charities. The research highlighted a lack of accountability by charities and suggested that more user-need driven reports would rectify this weakness and could possibly

lead to the more effective and efficient operation of charities. Within other research related to performance accountability in the wider not-for-profit sector, there is a clearly expressed recognition of the importance of such information. Research published over 20 years ago in the United States demonstrated fairly widespread reporting of performance information in a variety of documents across six types of NFPO. However, the focus of this reporting was on inputs, processes (or activities) and outputs, rather than on measures of efficiency and effectiveness, which were considered as more important. Research published in the late 1990s and related to performance measurement and performance accountability in the UK public sector, a sector that has been provided with considerable guidance (see below), showed that, over time, performance reporting had improved.

With regard to advice on developing performance measurement and performance reporting systems in charities, the CAF (2001) has prepared guidance specifically linked to their charities' annual report and accounts awards. However, the CAF guidance, while encouraging the publication of performance information, is quite short and limited in providing detailed examples and approaches. In addition, the Cabinet Office has included some recommendations with regard to measuring and reporting performance in its recent review of the charities and the wider not-for-profit sector. While the recommendations included in the consultation document (Cabinet Office, 2002) form a relatively small part of the review, which focuses mainly on legal issues relating to charities, and are lacking in detail, the principles expounded, and the fact that government has emerged as a 'champion of change', may suggest that future changes are likely in the not-too-distant future. By contrast, in the UK public sector, a diverse sector within which many organisations have similar characteristics to charities, the importance of measuring and reporting performance has been articulated strongly. Good performance measurement and performance reporting systems are viewed as necessary pre-requisites

for effective management and appropriate external accountability, two issues that are often considered as being strongly related. In the public sector there has been a plethora of guidance, much of it which could be 'read across' to charities, concerned with such matters as the attributes of performance measures and the design of performance information systems. Two examples of such guidance are reviewed in some detail in this research report (*Executive Agencies: A Guide to Setting Targets and Measuring Performance*, HM Treasury, 1992; *Choosing the Right Fabric (a framework for performance information)*, HM Treasury, 2001) and reference to several other UK and international publications that can be accessed *via* the internet is provided by way of an appendix (appendix two). While much of this guidance acknowledges that performance measurement is a difficult and complex task, and rarely, if ever, will there be a perfect measurement system, it promulgates the view that appropriately developed performance measurement and performance reporting systems can lead to more accountable organisations and support management in their planning and control functions.

### **Current practice**

The empirical analysis of annual reports contained in this research report sought to ascertain the current state of performance reporting by large UK fundraising charities and changes over time. This was achieved by identifying the extent to which basic background information and more specific performance information is used in external reporting. Two sets of charity annual reports, covering different time periods, were collected and analysed. Comparisons were made with similar earlier research. Basic background information was viewed as being important in providing an appropriate context for the understanding of the performance of a charity. The empirical results were presented and discussed. The main findings and arguments included in this aspect of the report were:

### There is extensive reporting of basic background information

It is argued that 'basic background information' (such as, for example: an indication of the governing instrument; details of how a charity is constituted; review of the year; and an explanation of the salient features of the accounts) is important to provide a context to understanding the performance of a charity. Both the CAF and the Charity Commission recommend the disclosure of such information. Seven items of basic background information were identified and reported, and with each item disclosure was extensive (at, or approaching, 100 per cent in each case) over the two reporting periods. This would suggest that most users of the annual reports of large UK charities have access to basic background information that may be useful in providing a context to the understanding and interpretation of any performance information.

### There is an inadequate discharge of performance accountability

Although previous charity accounting research has indicated that performance information has high importance to users of charity accounts and is recognised as having importance to users by providers of information, it is not widely disclosed by charities. Even allowing for the fact that there are many difficulties experienced by charities as they seek to measure performance, the results suggest that extant charity reports do not meet the most important information needs of users and therefore the relevance of such reporting can be questioned. For example, a significant proportion of charities reported no information on effectiveness and efficiency, the two key criteria for judging performance. With regard to the 2001/02 annual reports, 91 per cent of charities did not disclose a single measure of efficiency. Similarly, 71 per cent did not disclose a single measure of effectiveness. Given the importance to users of efficiency and effectiveness information,

a lack of publication suggests a charity sector where accountability for performance is not discharged in an adequate manner. Moreover, it is argued that such a lack of publication may disadvantage good performing charities. The disclosure of performance information, in cases where a charity has operated efficiently and effectively, may well increase its attraction to potential contributors.

There has been some limited improvement in performance reporting over time

Notwithstanding the above, there is some limited evidence of increased use of performance reporting by charities between 1990 and 1996/97, but no evidence of significant change since then. A comparison of this research with earlier research by Hyndman (1990) provides some limited insights into how performance reporting by charities has changed over time. Of five of the eight performance-related items analysed in this study that were also analysed in the earlier Hyndman study, average disclosure increased from 19 to 47 per cent by 1996/97. Greater reporting of goals and objectives, and outputs was particularly noticeable. However, there was a clear reduction in the percentage of charities disclosing efficiency information, one of the most important information types sought by users, perhaps indicating the increasing sensitivity of charities to publishing such information. Possible explanations for the general improvement in reporting may have been the increasing articulation of the importance of performance reporting by the CAF, evidenced by their promotion of the *Charities Published Accounts Awards* and the related guidance provided (CAF, 2001), and the influence of practices in the public sector, where performance-reporting systems have developed more strongly. Average levels of disclosure of the eight items of performance information reduced slightly between 1996/97 and 2001/02 (from 60 per cent to 53 per cent), mainly caused by the decreasing publication of effectiveness

information, again one of the most important information types sought by users. In this case, it appeared that there was a tendency to reduce the reporting of specific effectiveness information in the 2001/02 reports and increase the reporting of more 'marketing-focused' information. Indeed, in a number of matched cases, the annual reports of charities in 2001/02 were much glossier productions, replete with many photographs but contained fewer measures of effectiveness.

### Compared with the UK public sector, performance reporting is poor

Generally, in terms of the wider not-for-profit sector, the lack of disclosure of performance information is pervasive. However, it is interesting to note that this is not the case in the UK public sector, where many organisations display similar characteristics to charities and would appear to have comparable difficulties in measuring performance. In this sector, where there has been clear articulation from high levels in government of the need to develop appropriate performance measurement systems, the measuring and reporting of performance has improved significantly over time. This has been viewed as beneficial, both in terms of accountability and in terms of improving management within the sector. Given these developments, which have been encouraged by a proactive central support function, greater prescription and specific public sector guidance, the change in charity reporting is perhaps disappointing. While some effort has been made to highlight the need for charities to disclose more performance information, the concentration on specific guidance has been on financial accounting matters and this may have detracted from a meaningful debate relating to the relevance of the information content of charity annual reports.

## There may be a lack of willingness to disclose performance information

From previous research, it is clear that providers of charity information are largely aware of the information needs of users of charity reports but as is seen in this research, do not disclose. The research included in this report does not identify the reasons for this, but among possible explanations are: charities may be satisfied with existing reporting procedures; they may fear that some performance information may be misinterpreted; or they may take the view that the cost of providing such information is disproportionately high compared to the benefit received (indeed, it could be argued that a lack of disclosure is indicative of an efficient charity). Nevertheless, there may be economic incentives, as there are with businesses, for such voluntary disclosure. Disregarding accountability issues, it could be argued that in an environment where charities compete for contributions, the voluntary disclosure of performance information, possibly emphasising past performance and future plans, may enhance its attractiveness to existing and potential donors. Furthermore, in terms of the internal management of a charity, a weak regime of performance reporting externally may be indicative of a lack of availability of performance information to managers, suggesting poor planning and control within the charity. In a related argument, it has been suggested by some writers that managers in both public and private organisations may prefer limited performance reporting because they seek to avoid accountability.

## The scope for window dressing may have impacted on performance reporting

Although the case for some degree of independent verification of performance information included in external reports appears strong, the performance information identified in this study was not subject to

verification (as is the case with performance disclosures in most NFPOs). This scenario introduces the temptation for 'gaming' on behalf of the information provider. For example, as Beattie and Jones (1994) have argued, charities may, by a liberal policy of expenditure classification, attempt to minimise administration expenses in comparison with their charitable expenditures. The reducing scope to engage in such behaviour, with much greater prescription regarding expenditure classification in the more recent SORPs, may have impacted on the extent to which efficiency measures were disclosed (disclosure reduced from 21 per cent in 1990 to 9 per cent in 2001/02). Efficiency measures, particularly those relating administration costs to total costs, are often perceived as potentially damaging headline figures. Overall, with regard to performance information, if no verification of the performance numbers reported by a charity is required, then there may be a temptation to present performance in a manner that is perceived as more acceptable to the reader, for example by exaggerating good performance, regardless of its accuracy. Although, here again, cost/benefit issues need to be considered, given that external parties may use externally reported performance information to make judgements and decisions regarding a charity, then there appears to be a case for some degree of independent verification. While this issue has been discussed in the context of the public sector organisations with a suggestion being made that UK public sector organisations should aim to achieve 'independent validation' of performance information, there has been no significant debate regarding this issue in the charity sector.

### Limitations of study and further research

The analysis of the current state of performance reporting included in this research report focuses on the voluntary disclosure in annual reports of basic background information and more specific performance information by large UK charities. This research focused solely on large

fundraising charities and therefore generalisations beyond this group should be made with caution. Intuitively, it would seem likely that the extent of performance reporting would be significantly less with smaller charities (given the likelihood of less developed information systems and their lower resource bases). Indeed, with regard to financial reporting, researchers have found that the size of a charity was a determining factor of the quality of financial accounts, with larger charities having higher quality reporting. Given this tendency for smaller charities to have more limited accounting, and recognising the fact that the vast majority of charities are smaller than the ones studied in this research, it would be useful to explore whether a similar pattern emerges for performance information. If performance accountability for large charities is weak (as it has been shown to be in this study), it is possibly expected that performance reporting in small charities is extremely limited.

The research presented in this report considers the disclosure of basic background information and more specific performance information in charity annual reports. Among the points of reference for the analysis were the various SORPs and their performance-related recommendations. Given that a comparison over time was made (1996/97 with 2001/02), specific new recommendations from SORP 2000 were not the focus of analysis. For example, the extent of the adoption of the risk management requirements of SORP 2000 was not explored. Further research identifying the level and speed of adoption of these new requirements may indicate the extent to which the SORP is effective as a catalyst of change.

This research identifies weaknesses in performance accountability, but does not identify the reasons for this. Among the possible reasons suggested in this research report were: difficulties in measuring performance; general satisfaction with existing reporting procedures; fear that some performance information may be misinterpreted; the cost of providing such information is high and charity managers would

rather spend on direct charitable activities. Qualitative research, possibly utilising interviews, might help to provide useful insights to help explain the reasons for the current level of reporting of performance information.

In the light of a number of high-profile scandals, the issue of governance has come to the fore in a consideration of how both businesses and NFPOs are administered and managed. With regard to charities, a number of research studies have explored the issue (Hind, 1995; Gambling and Jones, 1996; Cornforth and Edwards, 1998). It could be argued that those charities with 'better' governance regimes are more likely to develop more extensive internal systems to target, measure and report performance, particularly performance related to effectiveness and efficiency. It may be the case that charities with better governance regimes may have more complete foundations on which to base the external reporting of performance and are therefore more likely to provide such information in their annual reports. The identification of key governance variables, possibly by reference to the recent research on governance and charities referred to above, and the relationship of these to performance reporting, might provide another rich area for further research.

This research focuses on performance information that was highlighted in some way in the annual reports of charities, referred to as hard copy, and not contained in the main narrative of the annual report (soft copy). This is not to say that non-highlighted performance information in the narrative of an annual report has no importance, but rather that it is difficult for the user to isolate and use. With regard to listed companies, Beattie, McInnes and Fearnley (2002), on the basis of an analysis of current narrative reporting practices of eleven food-processing companies, have argued that companies should be encouraged to make disclosures across a broad range of areas and to improve the quality of certain categories of disclosure. They use an integrated analytical framework that captures nine major topics, divided

into 79 sub-topics, and three dimensions of disclosure (capturing time orientation, financial orientation and quantitative orientation) to identify the quality of reporting. In addition, they distinguish between standard disclosures (information that has some information value) and premium disclosures (those that have high information value; the 'real nuggets') as a means for identifying the focus for reporting. While the primary research included in this report largely focuses on information that has been empirically identified as having real value to users of charities, as Beattie, McInnes and Fearnley (2002) might refer to as the 'real nuggets', a method similar to that used in the Beattie *et al.* (2002) study, but adjusted to reflect the NFPO dimension, might permit a more detailed analysis of the entire package of narrative reporting by charities (both as an entire sector, and within major sub-sectors of charitable activity). Such might be a challenging and fruitful way in which to extend the work reported here.

## **Concluding comments**

This research report contributes to the debate on the accountability of charities. It argues that well developed and appropriate performance measurement and performance reporting systems can help to discharge an important aspect of accountability. While accepting that there are substantial difficulties in measuring performance (even strong supporters of performance measurement systems realise that performance is often a contestable notion and cannot be measured perfectly), an awareness of these difficulties and an understanding of their potential impact can help the system designer. With an investment of time, effort and expertise in such a project, and a sensitive and intelligent approach, a system should emerge that can contribute to the discharge of accountability by, and the improvement of management within, charities.

The charity sector in the UK has grown significantly, is continuing to grow, and has a major economic and social impact. To maintain

confidence in the movement, improvements in accountability, and in particular with regard to performance accountability, would seem essential. Indeed, such improvements could be viewed as a necessary condition for further growth of the sector. However, without the provision and promotion of specific charity-focused guidance, possibly provided and promoted by those concerned with the administration and control of the charity sector in the UK, it is likely that the present limited state of performance reporting by charities will continue. Organisations that may be expected to have an interest in facilitating such provision include the Charity Commission in England and Wales, the CAF and the Scottish Charities Office. Indeed, the bones of such guidance could be 'read-across' from that existing in the UK public sector. Interestingly, the recent performance reporting recommendations included in the review of charities and the wider not-for-profit sector by government (Cabinet Office, 2002), promulgated a number of high principles regarding the measurement and reporting of performance, and may prove to be a necessary catalyst to begin a process of changing the focus of charity reporting. For example, recommendations relating to the provision of a Standard Information Return, which has a focus on objectives and outcome information, the provision of government support to the sector on performance improvement, and pilot testing of common performance indicators in specific sub-sectors of the sector (with subsequent benchmarking), indicate that the need for significant change in reporting is recognised, together with the need to support such change in tangible ways. With government as a 'champion of change', change may occur. Overall, if the annual reports of charities are to meet the information needs of users, guidance and support would seem essential. Given charities' expertise, focus and limited resource base, to expect individual charities to develop meaningful and extensive performance reporting systems without such guidance is perhaps optimistic.

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## APPENDIX ONE

### EXAMPLES OF MEASURES OF EFFICIENCY AND EFFECTIVENESS IN AGENCY ANNUAL REPORTS (HYNDMAN AND ANDERSON, 1997)

EFFICIENCY	
EXAMPLE	AGENCY
<ul style="list-style-type: none"> <li>• <u>Target</u>: Gross Unit Cost £76.60 <u>Actual</u>: Gross Unit Cost £70.61</li> </ul>	<ul style="list-style-type: none"> <li>• Vehicle Certification Agency</li> </ul>
<ul style="list-style-type: none"> <li>• <u>Target</u>: To reduce the unit cost of processing claims by 2% <u>Actual</u>: Actual reduction in unit costs 5.8%</li> </ul>	<ul style="list-style-type: none"> <li>• Compensation Agency</li> </ul>
<ul style="list-style-type: none"> <li>• Unit cost of determining written representation appeals: £683 per case</li> </ul>	<ul style="list-style-type: none"> <li>• Planning Inspectorate</li> </ul>
<ul style="list-style-type: none"> <li>• Productivity of vehicle testing: <u>Target</u>: 15.75 units per man day <u>Actual</u>: 16.01 units per man day</li> </ul>	<ul style="list-style-type: none"> <li>• Driver and Vehicle Testing Agency</li> </ul>
<ul style="list-style-type: none"> <li>• <u>Target</u>: To increase the productivity of Trade Mark examination by an average of at least 3% a year <u>Actual</u>: Target achieved</li> </ul>	<ul style="list-style-type: none"> <li>• Patent Office</li> </ul>

<b>EFFECTIVENESS</b>	
<b>EXAMPLE</b>	<b>AGENCY</b>
<ul style="list-style-type: none"> <li>• <u>Target</u>: To break even on the basis of full economic costs <u>Actual</u>: Not achieved. A loss of £2.583 million was generated on the operating account</li> </ul>	<ul style="list-style-type: none"> <li>• Natural Resources Institute</li> </ul>
<ul style="list-style-type: none"> <li>• <u>Target</u>: To provide a gross contribution of £7.0 million from commercial services <u>Actual</u>: Target achieved</li> </ul>	<ul style="list-style-type: none"> <li>• Meteorological Office</li> </ul>
<ul style="list-style-type: none"> <li>• Number of claims cleared: <u>Target</u>: 21,000 <u>Actual</u>: 21,840</li> </ul>	<ul style="list-style-type: none"> <li>• Compensation Agency</li> </ul>
<ul style="list-style-type: none"> <li>• <u>Target</u>: To deliver 3,600 man-days of uniformed personnel in support of exercises and military training <u>Actual</u>: 4,858 man-days delivered</li> </ul>	<ul style="list-style-type: none"> <li>• Military Survey</li> </ul>
<ul style="list-style-type: none"> <li>• Accuracy of payment of unemployment benefit: <u>Target</u>: 96.5% <u>Actual</u>: 96.4%</li> </ul>	<ul style="list-style-type: none"> <li>• Employment Service</li> </ul>
<ul style="list-style-type: none"> <li>• <u>Target</u>: 80% of planning appeals by written representation to be decided within 18 weeks <u>Actual</u>: Achieved within 19 weeks</li> </ul>	<ul style="list-style-type: none"> <li>• Planning Inspectorate</li> </ul>

# APPENDIX TWO

## USEFUL PERFORMANCE MEASUREMENT GUIDANCE

### Available *via* the Internet (with addresses)

#### Charity Specific

Charities Aid Foundation. Tell the Main Story: Guidance on Effective Annual Reporting. [www.cafonline.org/onlineawards/](http://www.cafonline.org/onlineawards/)

Cabinet Office (2002), Private Action, Public Benefit: A Review of Charities and the Wider Not-For-Profit Sector, Strategy Unit Report. [www.cabinet-office.gov.uk/innovation/2002/charity/report/index.htm](http://www.cabinet-office.gov.uk/innovation/2002/charity/report/index.htm)

#### UK Public Sector

Accounts Commission (Audit Scotland). Getting to know your services: a step by step guide to developing and using information portfolios to monitor and report performance. [www.accounts-commission.gov.uk](http://www.accounts-commission.gov.uk)

Audit Commission. Aiming to improve the principles of performance measurement. [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)

Audit Commission. On Target- the practice of performance indicators. [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk)

HM Treasury. Choosing the Right Fabric (a framework for performance information. [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

National Audit Office. Good Practice in Performance Reporting in Executive Agencies and Non-Departmental Bodies, Report by the Comptroller and Auditor General, HC 272 1999-2000. [www.nao.gov.uk/publications/index.htm](http://www.nao.gov.uk/publications/index.htm)

An extensive library of UK and international public sector information links and resources can be accessed at [www.cabinet-office.gov.uk/servicefirst/index/perform.htm](http://www.cabinet-office.gov.uk/servicefirst/index/perform.htm)

### International Public Sector

General Accounting Office (USA). Results-oriented Cultures- Insights for US Agencies from Other Countries' Performance Management Initiatives (report reference: GAO-02-862, published August 2002). [www.gao.gov](http://www.gao.gov)

Organisation for Economic Co-operation and Development. In Search of Results: Performance Management Practices. [www.oecd.org](http://www.oecd.org)

## APPENDIX THREE

### ANALYSIS OF THE ENTIRE SAMPLE OF 1996/97 (88) AND 2001/02 (66) ANNUAL REPORTS

*Table 1 Basic Background Information*

	DISCLOSURE				SIGNIFICANT DIFFERENCE
	1996/97		2001/02		1996/97 v 2001/02
<b>Number of annual reports analysed</b>	<i>Total Replies</i> <b>80</b>		<i>Total Replies</i> <b>66</b>		
<b>Item:</b>	<b>No</b>	<b>%</b>	<b>No</b>	<b>%</b>	<b>Total Replies</b>
(a) Indication of governing instrument	80	100	66	100	No
(b) Details of how charity constituted	80	100	66	100	No
(c) Review of the year	78	98	64	97	No
(d) Salient features of accounts explained	77	96	65	99	No
(e) Names of trustees	80	100	66	100	No
(f) Names of principal officers	80	100	66	100	No
(g) Address of principal/registered office	80	100	66	100	No

**Table 2 Selected Performance Information**

	DISCLOSURE				SIGNIFICANT DIFFERENCE
	1996/97		2001/02		1996/97 v 2001/02
Number of annual reports analysed	<i>Total Replies</i> <b>80</b>		<i>Total Replies</i> <b>66</b>		
Item:	No	%	No	%	Total Replies
(h) Goals and objectives	76	95	65	99	No
(i) Inputs	64	80	57	86	No
(j) Outputs	77	96	60	91	No
(k) Results	74	92	58	88	No
(l) Efficiency	4	5	5	8	No
(m) Effectiveness	54	67	17	26	1%
(n) Future target information	8	10	10	15	No
(o) Budget information	19	24	3	5	5%

## APPENDIX FOUR

### SUMMARY OF CLASSIFICATION RULES

1. To be classified the information must be highlighted or separate from the main narrative. This includes information in a different print, in tabular or diagrammatic form, or clearly standing alone under an individual heading.
2. If income from services is given, this is judged to be a measure of Results on the basis that the customer is free to purchase from any supplier and it is an indication of user satisfaction. When this is compared to a target it is a measure of Effectiveness.
3. If information is closely linked or a variation of other information given in the same table, chart *etc.*, it is only counted once.
4. If a table or graph includes information and the same information is disclosed in separate tables or graphs, then the information is counted only once.
5. When information is given twice or more at different levels of detail, it is analysed only once in its most detailed form.
6. When there is an efficiency target and the actual achievement of efficiency is given, this is counted as a measure of Efficiency only.
7. If an arithmetic calculation is made, for example dividing administration costs by total costs to give an administration cost percentage, then this was counted as an Efficiency measure.

8. If total costs and total administration costs are disclosed separately, but not specifically related to one another in an arithmetic calculation (a ratio), this is not included as a measure of Efficiency.
9. Where there is a quality target and the actual achievement of quality is given, this is counted as a measure of Effectiveness.
10. If output is compared with target/plan, it is counted only as Effectiveness.
11. If different financial statements are given, they are counted separately.
12. Notes to the accounts are not analysed separately.
13. A table with costs is only counted as one Input measure even if broken down into categories.
14. If cost recovery *v* target is given as a percentage of costs, this is counted as Effectiveness (monetary).
15. If overall customer satisfaction is given, this is classified as Results quality. If detailed specific findings of customer satisfaction survey given, this is classified as Output quality (*eg* speed of delivery).