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Qualified Opinion

Volume LVIII August, 2008 Number 3

At a Glance:

Next Meeting:

Sept 18, 2008

Carlyle's Grill
3660 Jackson Rd
Ann Arbor, MI
(West of Wagner Rd, at Quality Cinemas)

Pre-Dinner Meeting: 5:45pm, $12

Speaker: Robert Allen
Topic: School Funding

After-Dinner Meeting: 7pm, $25
(includes both meetings and Dinner)

Speaker: TBD
Topic: TBD

Carlyle's Menu
Steak Salad served with soup
Ahi Tuna Salad served with Soup
Rotisserie Herb Chicken & Carlyle salad
Wild Mushroom Ravioli & Carlyle salad
½ Rack of Ribs & Carlyle Salad
Jumbo Lump Crab Cakes & Carlyle Salad
Whitefish & Carlyle Salad
Steak Wrap served with Soup
Steak Pizza with a Carlyle Salad
***Dessert may be substituted for soup or salad*

RSVP TODAY! Make your reservation today with Mary Cortese at mfcgram@yahoo.com or call her at (734)-434-6218

Get ready for September events!

On **Tuesday, September 16**, the Michigan Association of CPAs will be holding its **Controller's Conference** in Livonia, Michigan. This one-day conference is the closest MACPA comes to focusing on issues that are also of primary interest to our fellow IMA members. Included among this year's topics are:

- Financial Statement Analysis for Profit Improvement
- Integrating the Planning & Budgeting Process
- FTC Guidance for Protecting Personal Information in the Workplace
- Accounting for the Lean Enterprise
- Design for Profit

Time: 8:00AM to 5:00PM **CPE Credits**: 8
Cost: $209 MACPA members, $309 non-members.
Location:
Radisson Detroit - Livonia
17123 Laurel Park Drive North, Livonia MI
Registration:
http://www.michcpa.org/Public/Conference/Register.aspx

Thursday September 18 is the beginning of our 2008-2009 program year. We have a dinner meeting with a presentation from Robert Allen, Deputy Superintendant of Operations, from Ann Arbor Public Schools. He will be addressing topics such as school funding, budgeting, sinking bond funds, the new high school, and capital improvement projects. Mr. Allen came to Ann Arbor from the Flint Community Schools, where he had been Chief Financial Officer. As CFO, his responsibilities cover most aspects of the district's financial operations and budget matters. Before joining the Flint schools, Mr. Allen held positions at Norfolk State University, Eastern Michigan University, and KPMG Peat Marwick. Trained as an accountant, he holds BBA and MBA degrees from Eastern Michigan Univ.

Performance: When Less Is More

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TRACKING TOO MANY PERFORMANCE MEASURES AT ONCE MAY CAUSE MANAGERS TO LOSE SIGHT OF WHICH ONES CONTRIBUTE DIRECTLY TO STRATEGIC OBJECTIVES. HAVING EMPLOYEES FOCUS ONLY ON THE KEY LEADING PERFORMANCE INDICATORS HELPS COMPANIES ACHIEVE BETTER RESULTS AND INCREASED FINANCIAL PERFORMANCE.

Public companies use quarterly and annual net income, operating income, and earnings per share to summarize their results for the past period, and these are widely reported in the business press. Measures of financial performance are dubbed “lagging indicators” because they reflect the results of the prior period. But in today’s fast-paced global economy, many companies focus on leading indicators as well. When appropriately identified, measured, reported, and evaluated, leading indicators can inform management of the progress being made on initiatives undertaken to achieve higher profits. Leading indicators are not a new phenomenon. For example, the variances computed with standard cost systems have traditionally provided managers with timely information on production inefficiencies, allowing them to focus their attention on unfavorable outcomes, to take corrective action, and to improve profits.

Since the early 1990s, many companies have developed balanced scorecards to link their strategic objectives, financial performance, and metrics associated with initiatives related to customers, internal business processes, and learning and growth. Many of the metrics associated with these last three categories are leading indicators. Favorable performance on these metrics is expected to lead to more favorable financial performance in the future. In describing the balanced scorecard, Robert S. Kaplan and David P. Norton suggest it should include 20 to 25 measures. They break this total down into five financial, five customer, eight to 10 internal, and five learning and growth measures. While upper management may find it possible to track and evaluate that many measures, those in distinct operating locations— such as individual stores, warehouses, and restaurants— may lose sight of the goal as they juggle their operation’s performance to meet these various targets. In fact, a 1998 report indicated that 70% of scorecard implementations fail. Too many metrics and too much reliance on historic financial measures prevent the balanced scorecard implementation from adding value to the firm.

It is no surprise that a 2004 study of successful scorecards found that the effective scorecards included only a limited number of metrics at the top, with supporting metrics listed below. Companies that have not developed balanced scorecards track their performance using a variety of measures. In fact, there is some evidence that these companies may track a great number of measures to assess their performance. Think about your own firm. Whether or not you use a balanced scorecard, identify how many measures you track on at least a monthly basis—either because you believe they are important or because someone else believes they are important. Is it less than five? Less than 25? More than 50? Even in firms that use a balanced scorecard to assess performance, managers may find themselves evaluating performance on more than 15 measures. With or without the balanced scorecard framework, it is easy for managers to become overwhelmed when trying to improve a variety of measures or get frustrated when improving performance on one measure results in lower performance on another, at least in the short term. Given the trade-offs involved in managing the results of multiple measures, managers can easily lose sight of those measures that link directly to strategic objectives and those that may have less long-term significance.

IDENTIFYING KEY INDICATORS

In a typical balanced scorecard, the four focus areas of financial, customer, internal business process, and learning and growth are usually found from top to bottom on the left-hand side. Initiatives (these may also be called objectives) for each area are found in the next column to the right. The initiatives identify actions (for example, hire additional line supervisors, secure new supplier) or goals (increase market by 5%, decrease rate of absenteeism by 10%) that managers are expected to achieve. Financial measures are lag measures. Initiatives in the other three areas are designed to lead to improved financial performance. As such, achieving these initiatives leads to improvements in future financial performance.

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Within some scorecards, the customer, process, and learning and growth may be assessed with what are termed lead and lag measures. Within this context, achieving the goal of a lead measure indicates that the initiative is on track, and achieving the goal of a lag measure indicates that the goal has been accomplished. For those readers unfamiliar with the layout of a balanced scorecard, an example can be found in "How Groups Produce Higher-Quality Balanced Scorecards than Individuals" in the Summer 2005 issue of *Management Accounting Quarterly*. While all of the customer, process, and learning and growth initiatives may seem to be tied to long-term strategic objectives, some items may be tied more directly so are more significant than others. One way to identify these key lead measures is to find those that are directly associated with many different areas of the balanced scorecard. Another way to identify key lead indicators is to identify the measures that you accumulate frequently and that result either in achieving strategic objectives or changing strategic objectives. Measures that you track only quarterly or annually cannot be key lead performance indicators. They don't provide timely information or allow for corrective action.

Home Depot Robert Nardelli came on board as the new CEO of Home Depot in 2000. At the time, the company faced a number of financial and operational problems that needed to be addressed to ensure its long-run profitability following 20 years of growth. At the store level, managers had considerable autonomy to respond to local market conditions, but this often translated into managers ignoring directives from headquarters. This entrepreneurial spirit also resulted in managers focusing on increasing their individual store sales at any cost, negatively impacting margins. Nardelli replaced the sense of "entitled autonomy" in the organization with a set of common objectives, goals, and metrics, and his efforts paid off as earnings per share doubled between 2000 and 2005. But that is not the end of the story. As management focused on all aspects of a store's productivity, customer service began to slip. Time spent measuring items ranging from how many pallets were removed from a truck per hour to how many extended warranties each employee sold per week translated into less time spent assisting customers. As result, sales began to slip. On January 2, 2007, Nardelli resigned as CEO and was replaced by Frank Blake, who made improving customer service a top priority. The Home Depot experience illustrates that a disconnect may develop over time between the organization's strategic objectives and its measurement system. A focus on the key leading indicators that improved the customer experience might have led to different results.

Steak n Shake A different set of measures was identified by the Steak n Shake Company. Steak n Shake is a restaurant chain that built a niche between quick-serve restaurants (for example, McDonald's) and casual dining (TGI Friday's). For many years, Steak n Shake recognized that appropriate levels of well-trained employees lead to more satisfied customers who generate larger revenue per customer order and more repeat business. In turn, satisfied customers lead to higher employee retention levels, in turn reinforcing customer satisfaction. To increase customer satisfaction and revenues, Steak n Shake focused on three key lead metrics identified through internal and external research. The measures were identified as those that drive individual restaurant performance: associate turnover, drive-thru window service times, and dine-in customer satisfaction. Each of the factors is an ideal key lead indicator because it can be measured frequently, thereby providing timely feedback on performance leading to future sales and profitability

How can other companies learn from these experiences? First, even if a balanced scorecard approach with 20 to 25 measures is used to assess strategic objectives, management may want to identify the three to five lead measures that most drive revenue and net income performance. Put simply, when communicating key metrics to employees, less is more. Second, it is important that these measures are communicated clearly to all employees. Third, employees should see the link between achieving the key lead measures and their compensation. This was clear in the Steak n Shake story. If the in-store dining experience is positive, customers are likely to order more, leading to higher tips for serving personnel. They are also likely to return and to encourage their friends and family to visit the restaurant, two more ways of increasing tips for service personnel. Fourth, companies should work to ensure that whatever metrics they use do not distract employees from seeing the goal clearly—increasing revenues, increasing income, and increasing positive cash flow

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