

**Master's Thesis**  
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**Performance Measurement & Management Control Systems**  
**Profit-oriented Corporations versus Non-profit Organizations**

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# ABSTRACT

- Title** Performance Measurement & Management Control Systems  
Profit-oriented Corporations versus Non-profit Organizations
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Gert Paulsson
- Objectives** Success in profit-oriented companies is most commonly measured by the amount of profit earned. The aim of this thesis is to:
1. Probe corresponding measures of success available and employed in non-profit organizations, and
  2. Based upon the belief of universality of management control principles, to find out the possibility of applying the same or similar techniques in both kinds of organizations.
- Methodology** Information on operations of the non-profit sector has been obtained through subjectively structured interviews with managers in large multinational organizations, and the researcher's personal observations based on previous work experience. Furthermore, the research is carried out by means of the application of qualitative approach in order to acquire insight into the ideas and points of view expressed in the interviews.
- Conclusions**
1. Although in theory Value for Money (VfM = Anticipated Outcomes / Required Resources), which is indicative of efficiency and effectiveness, can be considered a surrogate for profit in non-profit organizations, in the real world *evaluation* seems to be the closest measure corresponding to *profit*. The procedure specifies the actual outcome of projects, but, in contrast to profit figures which provide easy to grasp and concentrated information, here the results, reasons for deviations and different influential factors need to be analyzed and explained with words.
  2. In spite of shared basic principles, management control depends on prevailing situations and circumstances governing each particular organization in both sectors; thus the employment of an ultimate and conclusive system fitting all organizations and situations is unrealistic. Nevertheless, there are a number of control systems such as budget, the accounting system, auditing and project control that can be used in both kinds of organizations.

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# 1 Introduction

## 1.1 Background

Control is a controversial word that on occasions can be synonymous with holding power<sup>1</sup> or exercising tyranny and oppression, but in an organizational context it has been defined as the ability to create and monitor rules and regulations which should be followed<sup>2</sup>; or on the contrary, has been seen as a routine, repetitive task of observing, supervising, measuring and providing feedback<sup>3</sup>. Whatever the definition, the concept is viewed by many as the central nervous system of the operations in every organization<sup>4</sup>.

In all organizations, even the smallest, there is a function called *management control*. In relatively large organizations this function is rather formal and routinized; in smaller ones it may be quite informal. In large organizations management control systems are widely accepted as absolutely essential for regulating and monitoring activities<sup>5</sup>. Regulation in its turn is “fulfilling what has been laid down.”<sup>6</sup> Therefore, organizational control can be defined as ensuring that what was intended actually occurs, or that suitable adjustments are made in the light of changed circumstances<sup>7</sup>.

Every organization has goals, that is, it exists for the purpose of accomplishing something. Senior management of the organization decides on both the goals and the general nature of activities that should be undertaken in order to achieve them. Tactics and plans to achieve the goals are called organization’s strategies. After strategies are set and plans are made management’s primary task is to take steps to ensure that these plans are carried out, or if conditions warrant, that they are modified. This is the critical control function of management<sup>8</sup> and the objective of this important function is to assure that the organization implements its strategies efficiently and effectively.<sup>9</sup>

It should be recognized that, like control, *performance* is also an ambiguous term capable of no simple definition<sup>10</sup>. The most common definition of the term can be

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<sup>1</sup> Macintosh, Norman B., *Management Accounting and Control Systems* (1997), p.1.

<sup>2</sup> Ouchi, W. G., & Maguire, M. A., “*Organizational Control: Two Functions*” (1975)

<sup>3</sup> Reeves, T. Kynaston & Woodward, Joan, “*The Study of Managerial Control*” (1970)

<sup>4</sup> Macintosh, Norman B., *Management Accounting and Control Systems* (1997), p.1.

<sup>5</sup> *ibid*, p. 1.

<sup>6</sup> Lyne, Stephen, *Accounting Measures, Motivation and Performance Appraisal* (1995), p. 237.

<sup>7</sup> *ibid*, p. 237.

<sup>8</sup> Merchant, A. Kenneth, “*The Control Function of Management*” (1982), p. 43.

<sup>9</sup> Anthony, Robert N., & Young David, W., *Management Control in Nonprofit Organizations* (1998), pp.4-5.

<sup>10</sup> Otley, David, *Performance management: A framework for management control systems research* (1999), p. 364.

accomplishments of the organization<sup>11</sup>. We assume that an organization that is performing well is one that is successfully achieving its goals, and is effectively executing suitable strategies<sup>12</sup>. Moreover, performance is seen as multi-dimensional, overall status of an organization in relation to its competitors, or against its own or external standards. In measuring performance the popular shorthand is “The Three Es”, Economy, Efficiency and Effectiveness<sup>13</sup>.

Non-profit organizations do not have a way of measuring output that is comparable to the profit figures available in business enterprises. Nevertheless, these organizations need the best possible alternative that practically can be developed, because without some realistic measure of output there is no way of assessing either the efficiency or the effectiveness of the organization’s performance.

## 1.2 Problem Discussion

In profit-oriented corporations outputs of operations can be measured in monetary terms. Money provides a common denominator that permits the amount of individual resources and outcomes to be combined and measured, and financial measures of performance such as profit and revenues provide comprehensible measures of success or failure.

In non-profit organizations, outputs of operations are services, and services cannot be expressed or measured in monetary terms. Therefore, evaluating performance results is problematic as non-financial aspects of performance that need to be measured are difficult to define and even more difficult to quantify. No numbers can be assigned in feeding the hungry or providing shelter for the homeless. The available numbers in these cases would be how many were fed or how many shelters were constructed. However, any number of outputs measured is as good as any other, if output is looked at in general. To be meaningful, the numbers should provide information on how efficiently or effectively the job was done.

Efficiency<sup>14</sup> compares outputs with inputs: if more output can be produced with the same amount of input or the same amount of output can be generated with less input, the task is accomplished efficiently.

Effectiveness<sup>15</sup> is a subjective definition described as the relationship between objectives and attained results. The higher the scope of achievement, the more effective the task is performed. Since both objectives and outputs are difficult to quantify, measures of effectiveness are difficult to come by, and the concept is often expressed in judgmental terms such as this organization is doing a first rate job.

In profit-oriented corporations profit provides an overall measure of both efficiency and effectiveness. The more profit a firm makes the more effective it is (objective ↔

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<sup>11</sup> Euske, Kenneth J., *Management Control: Planning, Control, Measurement and Evaluation* (1984), p.3.

<sup>12</sup> *ibid.*, p. 364.

<sup>13</sup> Halloway, Jack et al. *Performance Measurement and Evaluation* (1995), p. 1.

<sup>14</sup> Anthony, Robert N. & Govindarajan, Vijay, *Management Control systems* (1998), p. 130.

<sup>15</sup> *ibid.*, p. 131.

result); besides, profit is the difference between revenue, which is a measure of output, and expense, which is a measure of input (expense ↔ revenue – input ↔ output); therefore, profit is also a measure of efficiency.

Although in recent years the trend in the profit sector has moved substantially towards more and more concentration and application of non-financial measures while evaluating the performance of companies, financial measures such as profit and return on investment still play a major role in the evaluations for the simple reason that, it is the *combination* of financial and non-financial measures that provides a complete and *all-embracing* view of the overall performance.

As non-profit organizations lack the financial measure components, they need to basically rely on non-financial indicators to assess the efficiency and effectiveness of their operations, and to rely on experience and expertise of their managers to evaluate the organization's performance. What adds to the aggregated problem of performance measurement in non-profit organizations is the fact that the managers in this kind of organization spend someone else's money on someone else! To elaborate more on this statement, Milton Friedman<sup>16</sup> classifies spending under four cases, depending on whether:

- You are spending your own money or someone else's
  - You are spending for your own benefit or for the benefit of someone else
1. If you spend your own money on yourself you are concerned with economy, efficiency and effectiveness.
  2. If you are spending your own money on someone else, as when buying a present, you are concerned with economy but less with efficiency.
  3. If you are spending someone else's money on yourself, as with an expense account lunch, you don't worry too much about economy but you are going to ensure effectiveness and to get your money's worth.
  4. If you are spending someone else's money on someone else then you have no direct motivation to seek economy, efficiency or effectiveness.

Managers in non-profit organizations are in the fourth position; and according to the author, this is the main cause of the carelessness and ineffectiveness in spending (donors') money by managers in this kind of organization. As a result, it is important that non-profit organizations seek to develop effective measurement systems to monitor and control the performance of their executives and managers in order to safeguard the interests of the beneficiaries.

### 1.3 Objectives

As a rule, earning profit is the main objective in profit-oriented corporations and success is measured by the amount of generated profits. The aim of this thesis is to investigate:

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<sup>16</sup> Friedman, Milton, *Free to Choose* (1988)

1. Corresponding measures of success available to and employed in non-profit organizations, and
2. Based upon the belief of the universality of management control principles, to find out the possibility of applying the same or similar techniques in both kinds of organizations

## 1.4 Constraints on the Scope of the Study

Investigating the application of performance and control systems in non-profit organizations only well-known international organizations are chosen, small local operations are excluded. Moreover, in this sector only charitable and governmental organizations are studied, religious and commercial ones are excluded.

## 1.5 Disposition of the Thesis

The outline of the paper is as follows:

**Part 1 Introduction**

Gives the background and a general view of the paper's subject of study.

**Part 2 Methodology**

Contains information on the scientific methods employed in the work and the choices made between different methods in collecting relevant data.

**Part 3 Performance Measurement**

The purpose of this chapter is to provide the reader with theories that help building up an understanding of the issue.

**Part 4 Management Control Systems**

Various descriptions of Management Control Systems by diverse theorists, practitioners and academics are presented here.

**Part 5 Profit-oriented Corporations Vs. Non-profit Organizations**

This chapter contains some general information on both kinds of organizations, a comparison between their characteristics, and their commonly employed performance measurement and management control systems.

**Part 6 Interviews**

This part is allocated to the collection of primary data through conducting interviews with managers in selected non-profit organizations.



**Part 7 Conclusions**

Presents conclusions drawn on the basis of obtained primary information as well as accessible secondary data.

## 2 Methodology

### 2.1 General Research Approach

In order to conduct a research the starting point is first to decide on a suitable perspective and then select appropriate methods of collecting relevant theoretical and empirical information on the concerned issue<sup>17</sup>.

In order to carry out the investigation at hand the qualitative approach<sup>18</sup> has been deemed most appropriate where the researcher's aim has been to acquire "insight" rather than statistical analysis. The data collected concern characteristics like ideas, concepts and points of view that cannot be quantified (measured or translated into numbers).

In this kind of research, the researcher's personal values are a requirement for the collection of data and interpreting them, and it is essential for the researcher to do his/her best to stay as neutral as possible while collecting the material and drawing conclusions, a task that can prove to be difficult to accomplish as all of us are influenced by different factors in our lives and life-styles<sup>19</sup>.

It should also be borne in mind that validity and reliability are two basic requirements in any kind of research. The question of validity<sup>20</sup> is concerned with the application of appropriate and adequate measures to collect the information, interpret them and draw conclusions. A research method is valid when it measures what is meant to measure. An example to simplify this definition could be: Is an IQ test an appropriate and adequate device to measure intelligence?

In qualitative studies it is difficult to establish the validity of a measure when the meaning of the concept in question itself is controversial and complex, as it is difficult to measure and interpret concepts and ideas such as measuring performance and controlling activities that is the issue in this paper.

Reliability<sup>21</sup> means that the measuring device, for example a questionnaire, needs to provide consistent and trustworthy evidence. It is the extent to which the chosen instrument gives dependable and steady results. The same results should be reached when the research is conducted independently of who the researcher is, given the same approach is used.

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<sup>17</sup> Wiedersheim-Paul, Finn & Eriksson, Lars Torsten, *Att utreda, forska och rapportera* (1991), p. 51.

<sup>18</sup> Bryman, Alan, *Research Methods and Organization Studies* (1995), p. 168.

<sup>19</sup> Patel, Runa, & Tebelius, Ulla, *Grundbok i Forskningsmetodik: Kvalitativt och Kvantitative* (1987), p. 44.

<sup>20</sup> Bryman, Alan, *Research Methods and Organization Studies* (1995), pp. 54-57

<sup>21</sup> *ibid*, p. 55.

### 2.1.1 Perspective

When conducting a research it should be clear from whose point of view the problem is tackled as we all have different perceptions of events and circumstances that surround us. Moreover, it should be noted that “Reality” in itself is a social construction, a concept that is created by people, and is a human product. Perception of this “reality” depends on who is asking the questions and who is answering them<sup>22</sup>.

Since this research studies management control devices the obvious choice of perspective is the managerial perspective. The informants who present their points of view are senior managers and heads of different departments within the organization.

### 2.1.2 Method Selection

In seeking to acquire a realistic picture of the research subject in examining the non-profit organizations the primary data is mainly collected through E-mail interviews. The application of E-mail has been necessary as interviewees have had different nationalities and have physically been residing in distant countries. Regarding the selected Swedish organizations, with the exception of IM whose main office is situated in Lund, the headquarters of the rest are located in Stockholm.

The advantages of E-mail interviewing over the personal face-to-face could be that interviewees have the possibility to take time to read the questions and reflect on the answers, there is no danger of misquotation on the grounds that the interviewer has not understood or captured the essence of what the interviewee has said, and if needed potential follow-up is possible.

Disadvantages could be the lack of opportunity to get immediate response on unclear points, and a limited possibility to ask for brochures or documents that would provide better understanding of the subject.

The composition of interview questions has been structured<sup>23</sup> in order to make people’s responses as comparable as possible. Each respondent is given the same questions as the other respondents. This practice allows the questioning to be standardized, so that variation in people’s responses can be recognized as authentic variations, and not according to differences in the manner or order of asking questions.

## 2.2 Specific Research Approach

Most studies on the performance measurement and management control systems have been conducted in profit-oriented corporations. The non-profit sector has been rather neglected. Therefore, collecting information and drawing conclusions in this thesis, the emphasis is put on the non-profit sector that can more or less be considered as uncharted waters.

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<sup>22</sup> Wiedersheim-Paul, Finn & Eriksson, Lars Torsten, *Att utreda, forska och rapportera* (1991), p. 39.

<sup>23</sup> Bryman, Alan, *Research Methods and Organization Studies* (1995), p. 41.

Collecting the primary data, large multinational organizations are subjectively selected according to the researcher's discretion of finding them interesting and contributing to the research issue.

In formulating the interview questions, my own personal past work experience in an international charitable non-profit organization has led the way to tackle different issues such as:

- The interviewees precise job description, which indicates what needs to be done and the degree of influence permitted in decision-making;
- In order to get to a destination one needs to know where one is going, therefore it is important to find out how concretely the goals of the organizations in general and interviewees departments in particular are defined;
- As management control is concerned with "assuring what is intended is achieved through taking corrective action when deviations occur", it is imperative to know about the possibility and the kind of actions taken to steer the operations back on track when things go wrong;
- Reward and punishment systems in place;
- And finally, performance measurement and evaluation systems in use

## 2.3 Primary Data

The primary information in this research is collected through conducting one personal (face-to-face), one telephone, and 5 E-mail interviews.

## 2.4 Secondary Data

In order to present factual information on the concerned organizations, internal materials and brochures provided by the interviewees have been of great assistance.

The accumulation of relevant theoretical information on the subject has been through the use of databases LOVISA and LIBRIS.

## 2.5 Criticism of Sources

The validity of data obtained through interviews can be questionable because of several factors:

- People are conscious of the fact that they are being studied, they may have limited memory, they may perceive certain issues incorrectly, and so on. These issues are often referred to collectively as the problem of “reactivity”.<sup>24</sup>
- Another problem is “social desirability bias”<sup>25</sup>, which refers to the tendency to reply in socially desirable ways when responding to questionnaires and interview questions. There is a good deal of evidence to suggest that people’s responses to questions can be affected by their perceptions of the social desirability of certain kinds of answer.
- There are suggestions that many people seek to present themselves in a more positive light when answering interview questions<sup>26</sup>.

These considerations imply that it is likely to be a gap between what people say they do and their true behavior, or between what they say they feel and how they actually feel. All these affect the level of validity.

The tool used to collect the primary information in this paper has been interview questions. In my opinion, this, in comparison with other means such as sending questionnaires or merely relying upon the data provided in the organizations’ publications, provides a more valid measure. In regard to reliability issue, I think it is reasonable to assume that no matter what researcher asks the questions, responses would be the same.

Based on my personal judgement, I do not believe the problem of “reactivity” would apply to the responses I have received from my ex-colleagues. On the other hand, it is possible that the existing personal relationships cloud my judgement.

I believe that the “social desirability bias” could impose a problem when the interviewees talk to the reporters from the mass media, saying things that the public would like to hear, maybe exaggerating a bit on achievements and trying to hide the shortcomings, but I do not suppose the same problem applies when the same interviewees respond to a researcher.

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<sup>24</sup> Webb et al., *Unobtrusive Measures: Nonreactive Research in the Social Sciences* (1966), pp. 66 & 143.

<sup>25</sup> Bryman, Alan, *Research Methods and Organization Studies* (1995), pp. 66 & 67.

<sup>26</sup> Thomas, K. W. & Kilmann, R. H., “*The social desirability variable in organizational research*” (1975), p. 171.

# 3 Performance Measurement

According to Torgerson<sup>27</sup> and Churchman<sup>28</sup>, measurement is assigning numbers to aspects and characteristics of objects according to rules. It is important to note from this definition that the rules of correspondence relate to the *properties* of objects, not to the objects themselves. For example, height, color, shape, weight or other characteristics of people can be measured but not people themselves, as it is not possible to measure the *essence* of an object. The same argument applies to performance which in itself cannot be measured, it is only possible to measure some characteristics of performance<sup>29</sup>.

## 3.1 Measurement Process

Various aspects and elements that constitute the measurement process are identified by an array of academics as: Scaling, Meaningfulness, Standards, Reliability and Validity.

**Scaling** - Scales are concerned with order, distance and origin characteristics of number series that are used in measurement processes<sup>30</sup>. To be more specific:

- Numbers series have an order
- The difference between numbers has an order, that is, the difference between any two numbers is greater than  $>$ , equal  $=$ , or less than  $<$  the difference between any other pair of numbers
- Series origin is indicated by zero.

The scale types are distinguished on the basis of the types of empirical operations that can be logically performed on the numbers. Underneath four traditional scales of measurement are discussed:

**Nominal Scale** - Is used as a device in order to *classify* the characteristics of objects. In this method, numbers are simply used to label or identify whether the object belongs to a specific category or not. A nominal scale can be created with signs, letters, or other marks of distinctions such as labels. For example in an accounting system, a number is assigned to the assets category and another one to the liabilities category. These numbers make a distinction between these two different categories.

The nominal scale is not considered a scale of measurement by some scholars<sup>31</sup> for the reason that this scale does not have any of the characteristics of the number series mentioned above; a simple classification of attributes cannot be considered a form of

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<sup>27</sup> Torgerson, Warren S., *Theory and Methods of Scaling* (1967)

<sup>28</sup> Churchman, West C., *Why Measure? Measurement Definitions and Theories* (1962)

<sup>29</sup> Euske, Kenneth J., *Management Control: Planning, Control, Measurement and Evaluation* (1984), p. 78.

<sup>30</sup> Torgerson, Warren S., *Theory and Methods of Scaling* (1967), p. 15.

<sup>31</sup> *ibid*, p. 17.

measurement. On the other hand, advocates<sup>32</sup> of the view argue that classification provides useful information; it is a process that in practice is widely used and taken into account while measuring performance.

**Ordinal Scale** - Is the nominal scale with the additional component of order. This scale shows whether a performance is better or worse compared to another similar performance. For example, a productivity rating of (4) in a second year of production compared to the rating of (2) for the previous year indicates that a certain program has been more productive the second year.

**Interval Scale** - Is the ordinal scale with the supplementary aspect of distance. The distance between any two numbers on this scale can be established and compared with the distance between any other two points on the scale. The origin in this scale is appointed subjectively. Examples are time, calendars and temperature scales of Fahrenheit and Celsius.

**Ratio Scale** - Is an interval scale with the added dimension of unique origin. The unique origin is defined as zero point; thus the scale depicts the actual count of items, such as the number of people in the room or the amount of cash in the bank.

**Meaningfulness** - Is defined as finding a common language for measurement that is easy to understand<sup>33</sup>. In this respect the choice of words is important, because the more precise the use of the words in describing the observable facts, the fewer the people who will be able to understand the information the words convey. On the other hand, the more generally the words are understood, the more the precision of the information diminishes. For instance, if accountants use common terms to describe items on the balance sheet more people would probably have some understanding of the balance sheet than if terms unique to accounting were used.

**Standards** - A standard can be viewed as a data reduction device that decreases and simplifies the amount of data required in a given situation. If standards did not exist, complete descriptions of the situations surrounding the object and characteristics of interest would have to be given so that comparisons of the characteristics could be made. For example, if generally accepted accounting principles (GAAP) did not exist, much more information would be required to ensure the comparability of the financial statements of two organizations than is now the case.

**Reliability** - Has to do with the level of discrepancy in repeated measurements of the same characteristics, and the degree of error that is considered acceptable<sup>34</sup>. Mock and Grove<sup>35</sup> are of the opinion that in the determination of accuracy, the concern is not that errors exist but in finding ways to identify, measure and eliminate the errors.

**Validity** - Concerns the relation between the measures and the properties measured<sup>36</sup>. For example, if company A shows twice as much depreciation on its

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<sup>32</sup> Stevens, S., S., *On the Theory of Scales of Measurement* (1947)

<sup>33</sup> Churchman, West C., *Why Measure? Measurement Definitions and Theories* (1962)

<sup>34</sup> Euske, Kenneth J., *Management Control: Planning, Control, Measurement and Evaluation* (1984), p. 86.

<sup>35</sup> Mock, Theodore J., & Grove, Hugh D., *Measurement Accounting and Information* (1979)

<sup>36</sup> Ijiri, et al., *The effects of Accounting Alternatives on Management Decisions* (1966)

financial statement as company B does, and if company A in reality has twice as much economic depreciation compared to company B, then the assigned numbers indicating the depreciation in two firms are valid measures.

## 3.2 Measurement Categories

According to Stevens<sup>37</sup> there are three types of measurements:

**Fundamental Measurement:** Is the direct measurement of extensions and characteristics of objects, such as a count of the cash at hand.

**Derived Measures:** Are obtained by manipulating other measures. For instance, an earnings per share is a derived measure. As in calculation, the values are determined by combining other measures. A large part of the results of an accounting system are derived measures.

**Fiat Measurement:** The measure is simply defined to be what it is. For instance, learning ability is defined as the number of trials and errors required to accomplish a task. Other examples of fiat measures are depreciation and profit, two measures produced by the accounting system.

## 3.3 Measures of Performance

Measures of performance are defined as the tools for evaluating whether organizations' goals and objectives are being achieved or not<sup>38</sup>. These measures are focused on different aspects of organizational activities; and in order to provide the user of the measures with concentrated information, the measured aspects are subjected to quantification<sup>39</sup>. The rationale for displaying the data in quantitative form is that the practice can furnish a clear picture of a vast amount of information that makes it possible to mull over and form opinions about the information in various ways<sup>40</sup>.

Another feature of measures of performance is that they can be visualized and presented with the aid of some medium, for example overhead slides or paper. The visual presentation enhances the effectiveness of information sharing. As Donald Norman<sup>41</sup> puts it: the ability to represent observations and experiences through some medium other than that in which they have occurred, eliminates irrelevant details.

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<sup>37</sup> Stevens, S., S., *On the Theory of Scales of Measurement* (1947)

<sup>38</sup> Euske, Kenneth J., *Management Control: Planning, Control, Measurement and Evaluation* (1984), p. 4.

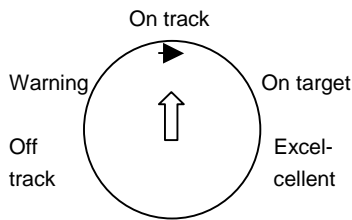
<sup>39</sup> Mossberg, T., *Utveckling of Nyckeltal* (1977)

<sup>40</sup> Tufte, E., R., *The Visual Display of Quantitative Information* (1983)

<sup>41</sup> Norman, Donald, *Things that make us smart* (1993)



Typically, measures of profitability, quality, productivity, lead time and product costs are to be found when considering performance measures<sup>42</sup>. An example of visual display of measures of performance is presented in figure 1.



### Lead-time

Figure (1) - Source: Adaptation from the book “Performance Measures and Managerial Work”, Mattias Elg, p. 3.

Managers can employ measures of performance as tools to satisfy diverse purposes<sup>43</sup> such as:

**Analysis** - Measures can be used either to make comparisons between different time periods (an abstract process) or discussions about real-world achievements (a concrete process). The measures are used for examining past activities in order to support or refute the past actions and learn from the mistakes. They provide the managers with tools for analysis and interpretation of organizational events, providing explanations why things have happened or not have happened.

**Organizing Future Activities** - Performance measures are a product of bottom-up information processing, that is, the data is collected from activities, computerized, registered and presented in various forms, then it is up to the managers to evaluate the information and decide on the future actions to be taken. Decisions made by managers are communicated to the operators, this time the information flow becomes top-down.

**Linking Different Units** - Performance measures are used for evaluation of different organizational units. This means that the information obtained may serve to link various units for constructing ideas about the functions of other units in relation to their own; and on occasions the information may be used in order to compare one unit with another.

**Generating Information** - Visual displays of the measures in form of charts, tables, graphs and diagrams have an important role in the development of knowledge<sup>44</sup>. The displays can be viewed as products of measurement processes in which information from different organizational units can be accumulated, summarized, and channelled to various managerial levels.

<sup>42</sup> Neely, A., & Gregory, M., “*Performance Measurement System Design*” (1995)

<sup>43</sup> Mattias, Elg, *Performance Measures and Managerial Work* (2001), p. 135-160.

<sup>44</sup> Latour, B., *Science in Action* (1987)

**Focusing Attention** - The idea here is that people usually focus on the things being in the center of measurement, especially if the process is followed up by certain rewards or retributions.

### 3.4 Commensurable & Incommensurable measures

The development and employment of commensurable (measurable by the same standard) measurement scales is driven by the desire of decision-makers to compare apples with apples. Comparable measures serve the need to understand the resources required to achieve an outcome. The benefit of such measures would be that the measurements themselves, when reported on the scale, provide the decision-makers with a defensible course of action. Commensurability rests at the heart of efficiency and effectiveness measures and ensures that arguments regarding different approaches to achieve the same outcome can be accomplished based on technical assessment, which utilizes the full benefit of a rational, objective approach<sup>45</sup>.

In non-profit organizations, where commensurable measures of performance such as ROI or EVA are not present, managers need to make choices to optimise the expected benefits created by their allocation of scarce resources using incommensurable, apples vs. oranges measures. This special burden requires the justification of one choice versus another without the benefit of a clear measure, which represents “better” from all possible perspectives, and decision-maker needs to use personal judgment to make a choice.

### 3.5 Measurement Dysfunction

Organizations develop hierarchies to better manage the variety of specialized activities, which take place within them. The result of specialization is differentiation of the processes within the organization and consequently the utilization and development of specialized knowledge. A consequence of this specialization is that a *principal* does not necessarily understand the measures or the justifications used by an *agent*. In these circumstances the desire to aggregate information to develop a commensurable measure, which can be used by the principal, e.g. an external funder, for decision-making, may lose essential information needed for decision-making by the agent.

The goal of commensurability is to ease the difficulty of decision-making by establishing appropriate metrics. However, if the goal of commensurability is poorly managed it can result in principals reducing the significance of all of the information required by the agent alone to only the information required by the principal. The

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<sup>45</sup> Cutt, James & Murray, Vic, *Accountability and Effectiveness Evaluation in Non-profit Organizations* (2000), p. 247.

inconsistency of information needs between the principal and the agent is the central theme of measurement dysfunction<sup>46</sup>.

## 3.6 Accountability

Cutt & Murray<sup>47</sup> maintain that the foundation of performance measurement is accountability and define the term as meeting information requirements through:

- Usage of common expectations about behavior,
- Stating performance in a shared language (currency), and
- Employment of shared standards in that shared language

This definition presumes the existence of at least two parties, one who allocates responsibility and one who accepts it with pledge to report on, and account for, the manner in which it has been assigned.

Accountability information can be defined at two levels: 1) A basic level dealing with observance of established processes and procedures, without explicit reference to programs or organizational objectives, and 2) A second level relates explicitly to the achievement of programs or organizational objectives and methods of operation. These levels are defined as procedural and consequential accountabilities<sup>48</sup>:

### **Procedural accountability**

The structure of accountability information for all sorts of programs and organizations is built on the basis of basic financial information. Managers are accountable for completeness and accuracy in the representation of financial information in the form of financial statements. In the light of budgeted financial information, this level of accountability represents shared expectations about accurate and complete representation of financial information. The shared language is obviously financial, and the criteria of accuracy and completeness are the set of standards that make up Generally Accepted Accounting Principles GAAP. As the foundation of accountability information, the financial statements are generally subject to verification, with respect to completeness and accuracy using GAAP, through financial audit.

The second element of procedural accountability requires managers to monitor and report observance of rules and regulations of their programs or organizations to a variety of authorities.

### **Consequential Accountability**

Consequential accountability deals with the issues of efficiency and effectiveness. In profit sector, the budgeted and actual statement of income and expenses provides information about intended and realized profit which is revenues minus expenses incurred in the earning of that revenue, and this single measure reflects explicitly

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<sup>46</sup> *ibid*, p. 250.

<sup>47</sup> *ibid*, p. 5.

<sup>48</sup> Cutt, James & Murray, Vic, *Accountability and Effectiveness Evaluation in Non-profit Organizations* (2000), pp. 11-12.

effectiveness of the achievement of objectives, and implicitly efficiency of the use of resources in the pursuit of the objectives.

In the non-profit sector, since the services are not sold, the revenue side of the financial statements simply describe the various sources of funding obtained by the organization. Therefore, these statements provide information only about completeness and accuracy of information on financial sources and uses (incurred costs), at the basic procedural level, and say nothing about consequential accountability.

As a rule, consequential accountability in non-profit organizations deals with two components, which together provide a non-profit *substitute* for profit measure in profit-oriented corporations<sup>49</sup>:

1. Information on the use of financial, human and material resources to provide services
2. Information on the service results achieved using available resources

The combination of the above mentioned information is called *Value for Money*. This concept in its most basic formulation was developed by legislative auditors in the public sector, and focused on measures of resource utilization (efficiency) and measures of the attainment of intended results (effectiveness). Therefore, by definition “Value for Money” which is “Anticipated Outcomes / Required Resources” can be considered the substitute for profit in non-profit sector.

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<sup>49</sup> Cutt, James & Murray, Vic, *Accountability and Effectiveness Evaluation in Non-profit Organizations* (2000), p. 15.

## 4 Management Control Systems

Management control has been deduced and interpreted in many different ways by different theorists and organizational sociologists. Although the various theories on the subject are not necessarily congruent and harmonious, a discussion of some of the major concepts that have been introduced is nevertheless a useful means to acquire better comprehension of the issue.

The essence of the Classical approach to management control is the notion that the central planners have superior knowledge of the inter-relationship and operating characteristics of the organization and are better able to take a corporate view of the organization and its inter-relationship with the environment. In this approach, tasks are unambiguously defined; minimal flexibility is permitted to subordinates; power, in the sense of formal authority conferred by the organizational hierarchy is relied upon, and compliance is engineered through use of sanctions and rewards. This view is characterised by the assertion that man is naturally lazy and wasteful, and the appropriate behavior can be bought by an exchange for money. The formal reward structure is an essential element of the classical “control package” and forms the basis of the economic analysis of agency theory<sup>50</sup>.

In the Neo-classical approach to management control, emphasis is placed on social and psychological aspects of organizations. In this view the focus is the diversity of individual needs and aspirations as a distinguishing feature of organizations that should be recognised in the analysis of organizational control. Principles of specialization, hierarchy and impersonality are considered to frustrate individual needs for autonomy, responsibility and self-actualisation. Advocates<sup>51</sup> of this view argue that effective performance, is only obtained when tasks are made basically stimulating and rewarding. Job enlargement and job enrichment programs increase the size, scope and variety of work. The emphasis on job involvement and self-control is central to the human resources analysis of organizational control.

In a slightly different vein, the human relations school has stressed the role of groups and the informal organization in influencing organizational activities<sup>52</sup>. Groups, particularly organized groups, it is argued, exert a powerful influence on behavior. Individuals have affiliate needs such as a sense of belonging, support, reinforcement, security, encouragement and so on, which can be satisfied by a group. Membership of a group involves mutual commitment and shared ideals which develops into organizational norms, and behavioral expectations discipline is enforced through a system of informal sanctions and rewards. For example, to hinder undesirable behavior, group support may be withdrawn and members may be ridiculed. Therefore, group pressure is a potentially significant source of control, which should be harnessed towards organizational effectiveness. The human orientation of neo-

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<sup>50</sup> Dent, Jeremy & Ezzamel, Mahmoud, “*Organizational Control and Management Accounting*” (1987), p. 86.

<sup>51</sup> McGregor, D., *The Human Side of Enterprise* (1960)

<sup>52</sup> Likert, R., *New Problems of Management* (1961)

classical management control theory, stands in some contrast to the structural and economic orientation of the classical approach.

On the other hand, Hofstede<sup>53</sup> defines management control as a practical concentration on results, which are obtained through employees' activities. He bases his theory on three aspects of management control: practicality, results and people:

- Management control is practical for the reason that it is used to achieve the organization's goals.
- It focuses on results, which indicate a successful or unsuccessful achievement of the goals.
- The control process affects and has to do with people in organizations, and employees are the main reason for organizations success or failure.

Newman<sup>54</sup> presents three types of management control in his theory: steering controls, yes-no controls, and post-action controls.

**Steering controls** are forward looking, attempting to adjust the working process before the task is complete.

**Yes-No controls** are screening controls, much like quality control on a manufacturing line; the element of interest is either accepted or rejected.

**Post-action controls** occur after the act is completed, when results are compared to a standard.

## 4.1 Market Mechanisms

According to Ouchi<sup>55</sup> there are three control mechanisms through which organizations are managed towards achieving their goals: Markets, Bureaucracies, and Clans.

In a Market system, competition determines the price that needs to be paid to obtain the desired goods or services, *price* being the amount considered as satisfactory compensation by the sellers and perceived as fair and reasonable by the buyers under the prevailing market conditions.

This kind of system simplifies the supervisory task of managers in the sense that the decisions made by subordinates can be checked against the simple criterion of cost minimization rather than observing the steps through which the decision has been reached.

The Market is also a system, which is based on a norm of mutual, give-and-take relations. In this system, as the costs of doing business among parties involved are

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<sup>53</sup> Hofstede, Geert, *Management Control of public and not-for-profit activities* (1981), p. 193.

<sup>54</sup> Newman, William H., *Constructive Control: Design and Use of Control Systems* (1975)

<sup>55</sup> Ouchi, William G., "A conceptual Framework for the design of Organizational Control Mechanisms" (1979), pp. 834 – 838.

linked with the assurance that the other party is dealing honestly, there are measures to punish those who try to falsify information, in order to deter potential cheaters<sup>56</sup>. In cases where honesty cannot be taken for granted each party is forced to pay a high cost of inspection, supervision, contracting and implementation in order not to get cheated, and these costs can quickly become so high that they can cause a market to fail<sup>57</sup>.

## 4.2 Bureaucratic Mechanisms

When the market fails as the mechanism of control a bureaucratic form most often replaces it. This kind of control system involves close personal observation, supervision, monitoring and management of subordinates by superiors. The information required to accomplish these procedures is incorporated in *rules*. These rules concern either work procedures, or indicate accepted standards of output and quality.

The rules in the bureaucratic mechanism differ from the prices in the market mechanism in the important sense that they are partial, rather than a complete collection of information, meaning that a price implies that a comparison between alternative buyers and sellers of the value of the object in question has taken place. A rule, however, is basically a subjective standard against which a comparison is yet to be made. In order to use a rule managers must observe some actual performance, allocate some value to it and then compare the allocated value to the rule in order to find out whether the actual performance was satisfactory or not. All of this brings about a good deal of administrative overhead costs.

Additionally, in a bureaucratic system an agreement on legitimate authority, usually of the rational or legal form, is essential<sup>58</sup>. Legitimate authority is a mutual agreement that, in exchange for pay, an employee gives up his/her independence in certain areas of work to his/her organizational superiors, accepting the idea that higher office holders have the legitimate right to direct, inspect, and monitor lower persons within some range<sup>59</sup>. Legal authority reinforces this agreement through formal channels.

## 4.3 Clan Mechanisms

Clan mechanism deals with the informal social structure of the organization. Each organization has its unique set of common beliefs, attitudes, norms, relationships and assumptions that are clearly or tacitly accepted throughout the organization<sup>60</sup>.

These shared values serve to reduce the goal incongruence between the organization's members. The extensive effect of these local values on the employees' behavior has

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<sup>56</sup> Gouldner, Alvin W., "The Norm of Reciprocity" (1961)

<sup>57</sup> Williamson, Oliver A., *Markets and Hierarchies: Analysis and Antitrust Implications* (1975)

<sup>58</sup> Blau, Peter M., & Scott, Richard W., *Formal Organizations*, (1962)

<sup>59</sup> Barnard, Chester I., *The Functions of the Executive*, (1938)

<sup>60</sup> Deal, T. E. & Kennedy, A. A., "Culture: A New Look through Old Lenses" (1983), , pp. 498-506.

been both theoretically treated<sup>61</sup> and empirically documented<sup>62</sup>. Since the clan does not have the unambiguous price mechanism of the Market or the specific rules of the Bureaucracy, for the purpose of control it needs to depend on a deep level of acceptance and common agreement between the organization's members as what is considered to be proper behavior.

The discussion above can be summarized in the following table:

### Social and Informal Prerequisites of Control

Type of Control	Social Requirements	Information Requirement
Market	Norm of Reciprocity	Prices
Bureaucracy	Norm of Reciprocity Legitimate Authority	Rules
Clan	Norm of Reciprocity Legitimate Authority Shared Values, Beliefs	Traditions

Source: William Ouchi, "A conceptual Framework for the design of Organizational Control Mechanisms" p. 838.

In reality, of course, we will never observe a pure market, a pure bureaucracy or a pure clan; these systems overlap and occur in various combinations in different organizations. In cases where the price requirements of a Market cannot be met and the social conditions of the Clan are impossible to achieve the Bureaucratic mechanism becomes the preferred method of control. In practice, the bureaucratic method of control is the easy-going type that is able to live in the widest possible range of environments, and ultimately becomes the dominant species as this system is basically governed by rules and does not have very demanding informational needs concerning prices or traditions.

Furthermore, there are scholars who have advocated the view that the control system of every organization is deeply rooted in its structure<sup>63&64</sup>. This group maintains that, as organizations grow larger, the number of levels of hierarchy increases, threatening the managers with the problem of control loss<sup>65&66</sup>. Besides vertical enlargement, with larger size also comes horizontal differentiation (more divisions and departments), each with a specialized task that differs from the specialized task of the other divisions. To deal with these problems different rules are introduced, that recommend, in an impersonal manner, specific behaviors. These rules are supposed to provide a means for individuals to know what needs to be done and how to

<sup>61</sup> Blau, Peter, M., *The Dynamics of Bureaucracy*, (1955)

<sup>62</sup> Selznick, Philip, *TVA and the Grass Roots*, (1949)

<sup>63</sup> Caplow, Theodore, "Organizational Size" (1957), pp. 484-505.

<sup>64</sup> Anderson, Theodore & Seymour Warkov "Organizational Size and function complexity: a study of administration in hospitals" (1961), pp. 23-28.

<sup>65</sup> Williamson, Oliver E., *Corporate Control and Business Behavior* (1971)

<sup>66</sup> Evans, Peter B., "Multiple hierarchies and organizational control" (1975)



accomplish the task properly<sup>67</sup>. In conclusion, arguments of this group clearly depict the organizational structure as the heart of the system, which controls the activities of the organization members through the application of different organizational procedures<sup>68</sup>.

In contrast, there are scholars who maintain that there is a distinction between control and structure<sup>69</sup>. This group argues that basically an organization's structure consists of:

- Vertical and horizontal separate units,
- The degree of centralization and decentralization, and
- The degree of formality and informality.

Next comes the organization's control system, which consists of two parts:

- 1) A set of conditions which govern the form of control to be used, and
- 2) The control system itself.

In this approach, the process of control is defined as monitoring something, comparing it with some standard, and then providing appropriate rewards or adjustments. The argument holds that in controlling the work of both the organization's members and the tools and instruments employed to achieve the organization's goals, there are only two phenomena which can be observed, inspected and evaluated, that is, behavior and outputs. This means that basically the control system can be regarded as being based on the monitoring and assessment of either behavior or output, bearing in mind that even in the case of output control, real control takes place only through changing the employees' behavior<sup>70</sup>.

In this view, it is a mixture of special circumstances which determines whether behavior control or output control should be applied in the organization. These circumstances are called *antecedent conditions*. Two types of antecedent conditions can be identified, and both are a necessary requirement for a logical application of each of the two types of control:

## 4.4 Behavior Control

In order to apply this kind of control the organization must possess a certain degree of knowledge about the means-ends relationships; meaning that the processes through which inputs are transformed into outputs must be known before supervisors can reasonably exert control by observing and guiding the behavior of their subordinates. For example, the manager in a manufacturing unit can observe the behavior of the workers. If they follow the established procedures they act in accordance with what is expected from them, and he can be certain that the expected product is being produced.

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<sup>67</sup> Merton, Robert K. *Bureaucratic Structure and Personality* (1940)

<sup>68</sup> March, James G., "The technology of foolishness" (1973)

<sup>69</sup> Ouchi, William G., "The Relationship between Organizational Structure and Organizational Control" (1977), p. 96.

<sup>70</sup> *ibid*, p. 97.

## 4.5 Output Control

In this kind of control supervisors do not need to know how the transformation process works. What they need is a reliable and valid measure of the desired output. For example, in the same manufacturing firm the manager can check the quality of the products, and ignore the behavior of the workers who have manufactured them.

The two parts of the control process, namely the antecedent conditions and the forms of control, can be combined into a matrix:

		Knowledge of the Transformation Process		
		Perfect	Imperfect	
Availability of Output Measures	High	(1) Behavior Control or Output Control	(2) Output Control	
	Low	(3) Behavior Control	(4) Ritual	

### Control type and its antecedent conditions

Figure (2) - Source: Ouchi, William, "The Relationship between Organizational Structure and Organizational Control". p. 98.

In the **first cell**:

- The transformation process is perfectly understood, and
- Good measures of output are available.

There is an option, either behavior or output control can be used. Example: manufacturing plants.

In the **second cell**:

- The transformation process is poorly understood, but
- Clear measures of output are available.

Only output control can be applied. Example: advertising agencies (measurable output: increase in sales); life insurance companies (measurable output: selling more policies).

In the **third cell**:

- The transformation process is well understood, but
- Clear output measure is not available.

Only behavior control can be applied. Example: a baseball coach knows how a good player must play and that the player's behavior can be influenced through training and supervising, but the coach cannot anticipate or control the number of home-runs the player would pull off in a game.

In the **fourth cell**:

- The transformation process is unknown, and
- Outputs are immeasurable.

Only ritualized control is possible. In circumstances where it is not possible to measure either behavior or outputs it is not possible to “rationally” evaluate the work of the organization. Under these uncertain conditions the substitute for rational form of control becomes ritual and tradition, where control is exercised through monitoring and evaluating attitudes, values and beliefs. As a result, this needs the strength of the membership ties which prevails in Clans mechanisms to endure.

This situation applies to non-profit organizations. As the only means of effective control, this kind of organizations need to rely heavily on strict selection procedures in recruiting candidates, in order to increase the possibility that the future employees would be able and committed individuals, who will meet the high standards of desirable performance.

### **Conclusions:**

- Though various models of management control exist, there is no definitive model of the concept. One reason for this could be that management control is concerned with controlling activities and behavior of people, but our ability to accurately predict or control human behavior is not well developed; therefore, management control is less than a science<sup>71</sup>.
- On the whole, theories on which management control principles are based are imperfect, since up to now, none of the presented explanations has had the ability to reliably forecast the actual outputs in relation to detailed and precise information available on inputs. Given that, the cause–effect relationship between various elements in the control process are not fully understood, any relationship could be questioned or possibly designed differently because of competing explanations for the same events. Therefore, as each of the processes in the management control system is built upon an incomplete theory, there is no guarantee that the system will work until it is *actually implemented*<sup>72</sup>.

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<sup>71</sup> Hofstede, Geert, *Management Control of public and not-for-profit activities* (1981), p. 193.

<sup>72</sup> Euske, Kenneth, J., *Management Control: Planning, Control, Measurement and Evaluation* (1984), p. 6.

# 5 Profit-oriented Corporations vs. Non-profit Organizations

A profit-oriented corporation is an organization whose existence depends on selling its goods or services to potential consumers of its products at a profit<sup>73</sup>. A non-profit organization is an organization whose goal is to provide services for the good of the community and/or on humanitarian grounds, without receiving any financial compensation in return.

Covering the non-profit sector, the main interest in this paper is placed on charitable social service organizations. These organizations<sup>74</sup> need to heavily rely on public support provided by governments and foundations. This means that their revenues do not directly measure the value of services provided to the clients (beneficiaries). Usually in this kind of organization, those that provide support (donors) tend to exercise an increasing amount of influence over the activities of the organization. Certain United Nations agencies, the Red Cross and Save the Children can be cited as examples.

## 5.1 Comparison between Profit & Non-profit Sectors

1. Comparing profit-oriented companies with non-profit organizations, a company that manufactures and sells tangible goods has certain advantages from a control standpoint that a social service organization does not have. In a profit-oriented company it is easy to keep track of the quantity of tangible goods, both during the production process and when the goods are sold, but it is not so easy to measure the quantity of many services. For example, we can measure the number of patients that a physician treats in a day, and even classify these visits by type of complaints, but this is by no means equivalent to measuring the amount of service the physician provides to each of these patients. Moreover, the quality of tangible goods can be inspected, and in most cases the inspection can be performed before the goods are released to the customer. If the goods are defective there is physical evidence of the nature of the defect, but the quality of a service cannot be inspected in advance, at best, it can be inspected during the time that the service is being rendered to the client. Judgments as to the adequacy of the quality of most services are subjective, and for the most part, measuring instruments and reliable standards do not exist.

2. In comparing the two kinds of organization, another interesting factor to consider is that profit-oriented organizations desire more customers, since more customers imply more revenues, and more revenues imply greater success. In non-profit organization, there is no such relationship between the number of clients and the success of the organization, on the contrary, as donations finance the amount of available resources additional clients may place a strain on resources. In a profit-

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<sup>73</sup> Emmanuel, et al. *Accounting for Management Control* (1995), p. 5.

<sup>74</sup> Anthony, Robert N., & Young, David W., *Management Control in Nonprofit Organizations* (1988), p. 61.

oriented company, the new client is an opportunity to be enthusiastically pursued. In non-profit organisations a new client may be perceived only as a burden imposed on limited available resources, and this negative attitude can lead to poor services rendered to these clients.

3. It should also be noted, that one of the main goals in charitable organizations is to decrease the number of clients rather than add to it. Charity organs seek to revitalize clients and remove them from the welfare system. This means that the needy are helped to access means to support themselves and become self-sufficient so that they do not need to depend on charity to survive. The idea that an organization should deliberately set out to reduce its customers is foreign to the thinking of profit-oriented corporations<sup>75</sup>.

4. In profit-oriented corporations a link between inputs (expenses) and outputs (revenues) can be established. In non-profit organizations the link between inputs (donations) and outputs (services) is ambiguous.

5. Unless providers of capital in profit-oriented organizations obtain a satisfactory return on their investments, the organization does not stand much chance of obtaining more funds. In non-profit organizations donors, who provide the funds, do not expect any financial rewards in order to go on with their donations<sup>76</sup>.

## 5.2 Performance Measures – Profit Sector

As discussed earlier, financial measures can only be employed in the profit-oriented sector where these measures help managers to control and regulate the flow of money through the organization. These measures serve two purposes: they measure the return given to the providers of finance (such as shareholders), and they present an assessment of the overall capabilities of the organization as a whole<sup>77</sup>. The most common financial measures are:

### 5.2.1 Profit

As a means to measure performance, profitability provides a measure that incorporates within itself a great many separate aspects of performance, with the key consideration not being the details of the operating statements but the net income. This measure is helpful both to the managers themselves and to those who judge their performance. It supplies managers with a current, frequent and easily understood signal as to how well they are doing, and it provides others with a basis for judging the managers' performances. Utilization of this measure has the following advantages<sup>78</sup>:

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<sup>75</sup> Anthony, Robert N., & Young, David W., *Management Control in Nonprofit Organizations* (1988), pp. 61-65.

<sup>76</sup> Berry Bob & Otley, David *Performance Measurement and Control: Research and Practice* (1996), pp. 39-41.

<sup>77</sup> Emmanuel, et al. *Accounting for Management Control* (1995), pp. 34-35.

<sup>78</sup> Anthony, Robert N., & Young David, W., *Management Control in Nonprofit Organizations* (1988), pp. 55-57.

- *Quantitative Analysis* – the easiest type of proposal to analyse is one in which the estimated cost can be compared directly with the estimated benefits. Such an analysis is possible when the objective is profitability, as profit is the difference between expense and revenue, and revenue is connected to benefits.
- *Decentralization* – as the main goal in profit-oriented corporations is to earn profit, and because the performance of many individual managers can be measured in terms of their inputs toward that goal, top management can safely delegate many decisions to lower levels in the organization.
- *Comparison of unlike units* – the profit measure allows a comparison of the performance of various operations that is not possible with any other measure. Profitability not only supplies a way of merging assorted essentials of performance within a company, it also provides a way of making valid comparisons among organizations that have the same goal, the goal of profitability, even though the size, technology, products and markets of these companies are quite different from one another<sup>79</sup>.

### 5.2.2 Economic Value Added (EVA)

Economic value added is a technique that has been developed by the Stern Stewart corporation in order to improve organizational control, and is defined as profit less a charge for capital employed:

$$\text{EVA} = \text{Net Operating Profit} - \text{Capital Charge}$$

$$\text{Capital Charge} = \text{Assets employed} \times \text{Rate}$$

The rate used to calculate the capital charge should be set by corporate headquarters and should be higher than the corporate rate for debt financing, because the funds involved are a mixture of debt and equity<sup>80</sup>.

According to its inventors, EVA is as an overall measure of financial performance with the ability to focus managers' minds on the delivery of shareholders value. As the aim of the stock market quoted organizations is to increase the stock market price of the shares of the companies, in other words to maximize shareholder values, it is argued that EVA is an important tool to measure the financial performance of these organizations<sup>81</sup>.

The idea behind EVA is that shareholders must earn a return that compensates the risk they have taken by investing in the business. In other words, equity capital has to earn at least the same return as similar risky investments on equity market. If this is not the case, then there is no real profit made and, in reality, the company operates at a loss from its shareholders' point of view. On the other hand, if EVA is zero, this

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<sup>79</sup> *ibid*, pp. 55-57.

<sup>80</sup> Anthony, Robert, N., & Govindarajan, Vijay, *Management Control Systems* (1998), p. 266.

<sup>81</sup> Bromwich, M. & Walker, M., "*Residual income past and future*", (1998), p. 409.

should be treated as a sufficient achievement because the shareholders have earned a return that compensates their risk taking<sup>82</sup>.

### 5.2.3 Return on Investment (ROI)

One of management's responsibilities is to arrive at the right balance between the two main sources of financing: debt and equity. Return of investment is a ratio that shows the relationship between net income and the investment, namely Profit/Investment. Investment is the shareholders' investments (i.e., equity), which consists of proceeds from issuance of stock plus retained earnings, and is the amount of financing that was not obtained by borrowing. However, for many purposes the source of financing is not relevant; "investment" then is the total of debt capital and equity capital.

Different companies calculate this return with different formulas and also call it by different names, such as return on investment (ROI), return on invested capital (ROIC), return on capital employed (ROCE), return on net assets (RONA) or return on assets (ROA). This method is widely used by companies because it is comprehensive, easy to calculate and easy to compare<sup>83</sup>.

### 5.2.4 Cash Flow from Operations (CFO)

Cash flow from operations is operating income before depreciation, and represents the total cash flow coming from the difference between cash in-flows and out-flows. The application of this method provides a measure of resource availability for future investments, dividends, and other uses of cash<sup>84</sup>, as monitoring cash flows enable managers to determine the availability of cash to meet maturing obligations, to pay dividends, and the amount of idle cash that can safely be invested for future use<sup>85</sup>.

Cash flow information is used to assess a company's liquidity (the firm's ability to convert an asset to cash or to pay a current liability), solvency (ability to obtain cash for business operations and its ability to pay its debts as they become due) and financial flexibility (the ability of a company to use its financial resources to adapt to change). It shows the ability of a firm to take advantage of new investment opportunities or to react quickly to "crisis" situations<sup>86</sup>.

## 5.3 Performance Measures –Non-profit Sector

As donors and fund providers in non-profit organizations want to know how well the funds are spent, measurements of some kind need to be made. For this purpose, evaluation can be a useful tool focusing on organizations' programs with the

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<sup>82</sup> Bromwich, M. & Walker, M., "*Residual income past and future*", (1998), P. 409.

<sup>83</sup> Anthony, Robert N., & Govindarajan, Vijay, *Management Control Systems* (1998), p. 234.

<sup>84</sup> Muehlhauser, G., H., "*Putting Performance Measure to Work*" (1995), p. 50.

<sup>85</sup> Schroeder, Richard G., & Clark, Myrtle W., *Accounting Theory* (1998) p. 329.

<sup>86</sup> *ibid*, p. 223.

objective of recommending whether these programs should be expanded, contracted, redirected, or discontinued.

The ideal evaluation process is one that provides indisputable evidence that what was intended to be done, is actually done. The question an evaluation process seeks to answer can be which program can make the greatest contribution for a given cost, or which program can achieve a given level of effectiveness at the least cost. These value-for-money questions are keys in the minds of fund providers who want to see the greatest return on the funds they provide. For example, a funder with only a limited amount of money to devote to the cause of helping the blind wants to put that money to work in a way that will have the greatest impact on that cause<sup>87</sup>.

Evaluation is carried out through examining results of past actions, and in order to do that the evaluator must work through several stages in the evaluation process<sup>88</sup>:

1. Designing the evaluation system by answering questions such as:
  - What is to be evaluated, e.g. programs, functions, or organizations?
  - What type of evaluation should be used? Outcome, process, input?
  - Who would perform the task? Operations managers, top management, or outside evaluation experts?
2. Choosing data collection methods by deciding what kind of data is required and what means should be used to collect them. For example quantitative data such as numerical counts and statistics or qualitative data such as interviews, focus groups and observations?
3. Developing standards for assessing the data, choosing between two basic kinds of standards:

**Absolute standards** – which are previously identified targets, against which the program is measured. Comparison of outcomes against these standards indicates how close the program corresponds to the specified set targets.

**Relative standards** – instead of using pre-determined targets results are compared with the results of similar activities or results from previous periods

4. Interpreting and using the results of the evaluation by answering the questions:
  - What do the results tell us about what can be done better?
  - Should something be changed?
  - Should the program be dropped?
  - Should more money be invested?

And in case of poor results to find out:

- Was it because evaluatees were poorly selected or trained?
- Was it because of a change in conditions beyond their control?
- Was it due to inadequate funding?
- Was it due to poor management?

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<sup>87</sup> Cutt, James & Murray, Vic, *Accountability and Effectiveness Evaluation in Non-profit Organizations* (2000), p. 31.

<sup>88</sup> *ibid*, p. 33.



In short, an ideal evaluation process requires:

- a) A clear statement of its objectives, they should be S.M.A.R.T: Specific, Measurable, Achievable, Relevant and Time bound; and
- b) A clear statement of the desired outcomes, which involves creating indicators or measures that fully reflect the desired outcomes and a process for interpreting the results of these measurements, i.e., what “good”, “average”, or “poor” results are. This means that there must be one or more pre-established, absolute standard(s) against which performance can be measured in a given time period, or relative standards that allow comparisons with others or the same program over time<sup>89</sup>.

### 5.3.1 Different Types of Evaluation:

**Outcome evaluation:** The ultimate objective of this kind of evaluation is to make a statement about outcomes, the end result of the activities that are being evaluated. To achieve this, the evaluation effort is focused directly on getting information on specified outcomes.

**Process evaluation:** Evaluation attempts to measure the occurrence of a specific set of recommended activities undertaken by the evaluated. For example, if the evaluator’s focus is on a leadership function, such as the way the board of directors governs the organization, a process evaluation would seek to measure various aspects of the way it runs its meetings, how it goes about setting goals for the organization, or the roles and responsibilities of its committees.

**Input evaluation:** Processes cannot occur without the initial investment of financial, human and technological resources to make them happen. It is, therefore, possible to perform an evaluation of these inputs. For example, how much money was put into a given project, how many person-hours were devoted to it, how much computer technology was put in place, how much management time was invested in developing the project, etc<sup>90</sup>.

**Subjective Evaluation:** The large majority of program measurements are subjective, as they are judgments arrived at by personal observations by an individual or a small committee. The validity of such evaluations depends heavily on the expertise of those involved. Findings are also influenced by the situations which the evaluators happen to observe; that is, they may be unduly impressed by what *appears* to be either excellent or poor results in particular cases. For this reason, it is desirable that the evaluators develop statistical or other data as a means for adding credibility to their opinions.

**Statistical Evaluation:** In this method relevant data about the programs is collected routinely and the focus is placed on the development of performance in order to determine whether and how much performance has improved or worsened; current results of the programs are compared with the results of others, presumably similar

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<sup>89</sup> *ibid*, p. 35.

<sup>90</sup> *ibid*, pp. 31-32.

ones, or current results are compared with the results that were anticipated when the program was started.

**Sample Survey Evaluation:** This kind of measurement deals with an investigation of samples of the target group, for example, the people that the program is intended to benefit, or the ones that can provide useful information on the subject. The survey may be either in the form of a written questionnaire or of oral interviews. In order to provide valid results, survey questions must be worded so that the respondents could give clear and understandable answers, and the sample of selected people must be representatives of the a much bigger population under investigation<sup>91</sup>.

### 5.3.2 The Value Sieve

The Value Sieve<sup>92</sup> is a choice prioritization process, which results in a decision-maker choosing among alternative incommensurable options. The heart of the Value Sieve methodology is the systematic use of information within a dependable accountability structure. This is essential for the coordination of information feedback so that the programs of the organization can be adjusted to better meet their individual and collective organizational goals and objectives.

The process requires decision-makers to specify their objectives and within the context of that objective compare the available program alternatives. In this approach, managers need to determine Value for Money (VfM) of different options. VfM is the ratio of expected benefits to required resources, in other words:

$$\text{VfM} = (\text{Anticipated Outcomes} / \text{Required Resources})$$

VfM is determined by what was delivered. It can be seen from the equation that when the delivered outcomes are lower than originally estimated or when the resources required are higher than the original estimates a loss of VfM would result. Accountability requires that decision-makers should explain the difference between what was estimated and what was delivered and to adjust their future decision-making accordingly.

Assessment of the VfM of each possible alternative program creates a priority list of the alternative programs. The priority list shows the maximum contribution of each program towards the desired objective.

### 5.3.3 Peer Review

During recent years major efforts have been under way to devise new methods of ensuring that the quality of services provided in the non-profit sector is adequate. Although the movements have different labels the common characteristic among them is the belief that in general, when the principal output of an organization is the

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<sup>91</sup> *ibid*, pp. 759-761.

<sup>92</sup> *ibid*, pp. 247&260.

work of professionals, other professionals best judge the quality of that output, and the following questions should be asked and answered:

- Is the service necessary?
- Is the performance up to recognized standards?
- Is the service delivered in the most economical fashion?

This kind of review exists in organizations such as hospitals and universities, in which professional decision-making is a critical activity. For example, universities have mechanisms for reviewing the performance of their faculty members, and are themselves subject to review by accrediting agencies<sup>93</sup>.

In this kind of review a team of colleagues, that is peers who work at similar organizations, conduct the evaluation. The team is guided in part by specified minimum standard (e.g., for a college, the number of books in the library, the proportion of a faculty with advanced degrees) and in part by observation and discussion; a favorable conclusion means that the institution meets certain minimum requirements. It should be noted that a colleague review tends to focus on the activities of an organization's professionals and not on the question of a program's effectiveness.

## 5.4 Performance Measures applicable to both sectors

### 5.4.1 Comparison against standards

Major standards against which performance can be compared comprise of:

- The performance of the same organization in earlier time periods,
- The performance of similar organizations, and
- Estimates of expected performance made by the organization ex ante.<sup>94</sup>

Generally speaking, managers avail themselves of three types of standards<sup>95</sup>:

**Budgeted Standards:** A carefully prepared budget takes into account the conditions that are expected to exist in the budget year, and the revenue and expense items show the expected monetary effect of these conditions.

**Historical Costs:** Some organizations compare current performance with performance in the past. Generally, a historical standard is not as good as a well-prepared budget for at least two reasons: (1) conditions in the current period could be different from those of the prior period, which lessens the validity of the comparison, and (2) performance in the prior period may not have represented a good performance.

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<sup>93</sup> Anthony, Robert N., & Young, David W., *Management Control in Nonprofit Organizations* (1988), p. 559.

<sup>94</sup> Emmanuel, et al., *Accounting for Management Control* (1995), p. 30.

<sup>95</sup> Anthony, Robert N., & Young, David W., *Management Control in Nonprofit Organizations* (1988), pp. 702-704.

Despite these limitations, historical data are better than those in an inaccurately prepared budget, and as they are drawn directly from the accounting records, they are not influenced by the judgments and convincing arguments that sometimes affect the budget numbers.

**External Standards:** Means benchmarking against other organizations in the same sector with similar agendas. For example, the performance of a hospital or a university can be compared with other hospitals and universities. If the conditions in each of these institutions are reasonably similar a comparison of this sort can provide a realistic basis for judging the performance of their managers.

### 5.4.1 Benchmarking

Organizations can obtain an understanding of the weak and strong points of their operations through benchmarking (comparing) their activities with those of other relevant organizations. The key objective in benchmarking is to make changes that lead to continuous improvements in products, processes and services that result in competitive advantage. Increasing market globalization and the pressures of international competition mean that organizations intending to become or remain among the leaders in their respective fields should aim to develop into the “best-in-class” in the key areas that maintain competitive advantage. The best-in-class achievement becomes a recognized standard of excellence against which similar things are compared.

Although it is difficult to compare the key operational issues in the non-profit sector, some areas, such as staff productivity improvement, job design, facilities layout and design, are capable of being benchmarked. Here lessons can be learned from the practice of those organizations that are leaders in a field or with whom valid comparisons can be made<sup>96</sup>.

**The General Process:** The process of benchmarking can be expressed generally as covering the following activities<sup>97</sup>:

- Determining the key performance areas;
- Setting the key standards and variables to measure;
- Identifying the most relevant competitors and “best-in-class” companies;
- Measuring regularly and objectively;
- Analysing the best-in-class performance;
- Specifying programs and actions to close the gap and their implementation;  
and
- Monitoring ongoing performance.

**Sources of Information:** The list below indicates the types of information sources, which may be relevant to best practices benchmarking activities<sup>98</sup>:

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<sup>96</sup> Dence, Roger, *Best Practices Benchmarking* (1995), pp. 124-125.

<sup>97</sup> *ibid*, p. 132.

<sup>98</sup> *ibid*, p. 136.

- Media information (professional and trade press);
- Analyst reports (public companies), financial data and credit rating reports;
- Published market research reports and consultant studies;
- Industry and trade associations;
- Professional networks within the firm or industry;
- Competitors (site visits, products, corporate and product literature);
- Consultancy or academic bodies operating benchmarking databases; and
- Industry information exchanges.

### 5.4.3 Balanced Scorecard (BSC)

Kaplan and Norton have developed the Balanced Scorecard approach at the Harvard Business School in the early 1990s. The concept is an essentially multi-dimensional approach to performance measurement, and is linked specifically to organizational strategy. The technique supplements traditional financial measures with three additional perspectives: Customer Perspective, Internal Business Process Perspective, and Innovation and Learning Perspective. Since the four perspectives are equally important in the long run they should be balanced against each other, that is, no one perspective should be allowed to dominate over the others and, in order not to lose focus, the number of measures should be limited to approximately 20.

In this approach, certain non-financial information referred to as key success factors are considered to be key indicators of how well the chosen strategy is being implemented. These critical factors determine the success of the company's strategy and show the relationship among the individual measures in a cause-effect manner<sup>99</sup>.

**Non-profit Sector:** It has been argued that for non-profit organizations the traditional Balanced Scorecard must be adapted to the reality of cost-effectiveness rather than profit. While the primary objective should be stated in terms such as the maximization of long-term benefits (the assigned money value of services minus long-term expenses), in operational terms the objective would be to maximize long-term service effectiveness. The other components of the Scorecard can include information from the other three perspectives and two further dimensions, that is:

- a) Financial Results, including revenue results from fund-raising activities and others, and
- b) Financial Expenditure, to serve together with revenue information as a tool of providing procedural accountability information in the form of financial statements, and independently as a tool of generating program cost information.

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<sup>99</sup> Kaplan, Robert S., & Norton, David P., "The Balanced Scorecard – Measures that Drive Performance" (1992), pp. 71-77.

## 5.5 Management Control Systems applicable to both sectors

### 5.5.1 Budget in the Profit Sector

Budgeting has customarily been a central tool of most organizations' control mechanisms, as it is one of the few systems capable of combining the whole range of organizational activities into a single articulated review. A budget may represent an organization's expectations and contains the amounts the organization expects to spend. A budget may also reflect organizational ambitions as it contains figures the organization hopes to receive under favorable conditions. The total amount of money and its distribution among various activities are designed to support an organization's goals<sup>100</sup>.

A budget is also a network of communications, where information is being continuously generated and fed back to participants. Once enacted, a budget becomes a guide; the fact that something has been done before vastly increases the chances that it will be done again.

The advantage of the budgetary control process is that it offers an encompassing structure by means of which all aspects of an organization's activities are squeezed into a single set of financial statements, against which actual outcomes can be examined. Although a budget is a record of the past, it is also a statement about future events. Budgets are predictions that try to establish future states of affairs through a series of current actions. They specify connections between words and numbers. A budget is a mechanism for allocating resources. If the aim is to obtain desired objectives at the lowest cost, a budget may become an instrument for pursuing efficiency.

In spite of the fact that budgeting has limitations as it focuses only on financial results and does not pay sufficient attention to the means by which these results are to be achieved, it still represents the central co-ordinating instrument that most organizations have<sup>101</sup>.

### 5.5.2 Budget in the Non-profit Sector

Budgeting<sup>102</sup> is perhaps the most important part of the management control process in non-profit organizations, since for them the budget specifies the way in which activities are to be conducted in the coming year. The initial budget is a program budget, that is, one that focuses on the amounts to be spent on each program, and

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<sup>100</sup> Otley, David, "Performance Management: a framework for management control systems research" (1999), pp. 370-371.

<sup>101</sup> Wildavsky, Aaron, *Budgeting, a comparative theory of budgetary processes*, (1986), pp. 7-9.

<sup>102</sup> Anthony, Robert N., & Young, David W., *Management Control in Nonprofit Organizations* (1988), pp. 871-872 & 538-540.

since the annual revenue in these organizations is more or less a fixed sum, managers must adhere closely to the amounts expressed in the budget.

In addition, managers in this kind of organizations should plan to incur expenses that are more or less equal to revenues, because if budgeted expenses are below revenues it could be an indication that the organization is not providing the quantity of services that the donors have the right to expect. On the other hand, if its budgeted expenses exceed its revenues, the difference has to be made up by cutting down the spending on the ongoing programs or abolishing some of them. In general, it can be said that expenses measure the quantity of resources consumed, and are therefore the best financial indication of the inputs that are used to accomplish whatever the organization does.

In many non-profit organizations, the total of the budget for a year represents an absolute upper limit, which cannot be exceeded except under highly unusual circumstances. However, changed circumstances will usually require changes in detailed spending requirements, and there are situations where the problem of adjusting the spending within the prescribed maximum limit arises. There are two general techniques for solving this problem:

**Emergency Allowances:** In this approach amounts are set aside at various levels in the organization for unforeseen emergencies. Such amounts are ordinarily not more than 5 percent of the budget for that level. Under this plan the budgeted expenses for each responsibility centre and program are targets, which can be exceeded if necessary, with the excess being absorbed by emergency allowance. An advantage of this approach is that increases in spending can be met without a need to find an equalizing decrease in other programs.

**Revision Procedure:** Through this procedure, the authorized amount is divided among responsibility centres. Increasing the budget of one responsibility centre and making an equivalent reduction in the budget of some other responsibility centre reflect changed circumstances.

Whichever approach is used it is important to recognize the likelihood that changes may be necessary. Otherwise, the budget may not be consistent with the realities of the situation, and it will not serve as a reliable plan against which actual performance can be measured.

### 5.5.3 The Accounting System

Accounting information plays a central role in both kinds of organizations, where it provides a means of quantifying overall performance. Since accounting information is expressed in monetary terms it can be collected across the different departments and sections, and be combined into total measures of performance<sup>103</sup>.

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<sup>103</sup> Emmanuel, et al. *Accounting for Management Control* (1995), p. 34.

In the non-profit sector the aspects of the accounting system that are most relevant for the control of operations are<sup>104</sup>:

**Donor Restrictions:** The accounting system must be designed so as to assure that any limitations placed on donations are observed. If a donor specifies that a donation can be used only to build schools, for example, this restriction must be honored.

**Integrated Systems:** It is advantageous if the accounting system can be an integral part of a total information system that reports on both inputs and outputs, for example, municipalities can develop such integrated systems that include budget and accounting information plus statistical information on population, public safety and economic development programs.

**Liability Accounting:** This system of accounting is designed in order to avoid spending more than the amount specified (as in the budget or by donors). In practice, it should also discourage spending less than the budgeted amount, and is used when a contract is entered into, such as when personnel work and become entitled to salaries, and when the organization becomes obligated to pay for goods or services.

The first step in this kind of accounting is to record the amount specified for each program; the next is to charge the stipulated amounts for obligations in separate allocated accounts; when goods or services are received the accounting system records the transactions. The accounting process can, from this point on, be the same in a non-profit organization as in a profit-oriented corporation.

#### 5.5.4 Auditing

In both sectors organizations exercise two kinds of inspections to review and assess their operations, *viz.*, internal and external auditing<sup>105</sup>:

**Internal Auditing:** The objective of internal accounting control is to provide reasonable assurance as to the safeguarding of assets against loss from unauthorized use or removal of assets. The management control system should contain its own controls in order to minimize the possibility of loss by theft or fraud, to ensure that rules governing the receipt and spending of money are adhered to, and to ensure that the information flowing through the system is accurate.

**External Auditing:** Both kinds of organization have a responsibility to account to the public, and an obligation to have their accounts audited by external auditors. These audits would establish whether financial operations are properly conducted, whether the financial reports are fairly presented, and whether the organization has acted in accordance with appropriate laws and regulations.

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<sup>104</sup> Anthony, Robert N., & Young, David W., *Management Control in Nonprofit Organizations* (1988), pp. 541-544.

<sup>105</sup> Anthony, Robert N., & Young, David W., *Management Control in Nonprofit Organizations* (1988), pp. 547-550.



### **5.5.5 Project Control**

In this kind of control the focus is on the completion of a project, which in many cases can extend over a period of years. A project control system takes account of three aspects of the project: the cost of the project, the quality of it, and the time required to complete the task. Taking these factors into consideration a work schedule and a related budget are prepared. As the next step records of actual outputs and actual costs incurred are kept. The cost data are collected in a disciplined accounting system, and reports are prepared from these records at frequent intervals. These records should be such that reasons for significant revisions can be easily identified. Based on these reports, if necessary, revisions in the plans and budgets are made. Once plans and budgets have been revised ensuing management records can be compared with the original budget and variances identified.

### **5.5.6 Information Reports:**

Information reports are designed to tell management what is going on. The information contained in such reports may come from the accounting system, but it may also come from a wide variety of other sources. A list of non-accounting information reports would be very long, and could include reports on such internal information as the number of new clients or patients, service deliveries that did not meet quality standards, admission applications, the number of failing grades, the number of accepted applicants who decide to attend a university and so on. External information reports could include such items as general economic conditions, new government regulations, competitors' performances, etc.

### **5.5.7 Performance Reports:**

A performance report focuses on the performance of a manager and is called a control report. Each responsibility center in an organization is expected to do its part in helping the organization to achieve its goals and objectives. The purpose of control reports is to communicate how well managers of responsibility centers perform in comparison to both the budget and any other standards that are set for performance.

This kind of report compares actual performance with what performance should have been, considering the actual circumstances. If there have been uncontrollable reasons, or if any of a number of other circumstances has changed, a negative variance can be justified and not interpreted as indication of poor performance.

The above mentioned control reports are feedback mechanisms, but they are only one part of the control process. A control report by itself does not lead to a change in performance; this happens only when a manager gets involved and takes action. In order for a manager to take action conducting a three-step process is necessary:

- a) A review must be made and an area must be identified as a candidate for action,
- b) The area must be investigated to determine whether action is warranted, and
- c) When necessary, some sort of action must be taken.

## 5.6 Summary:

### **Characteristics associated with non-profit organizations:**

1. Lack of a profit requirement
2. Inclinations to provide services
3. Dependence on donations for financial support
4. Subject to external influences
5. General lack of adequate performance measurement & management controls

### **Traits regarding profit-oriented sector:**

1. Earning profits is normally the main goal
2. Production of goods and providing services
3. Capital is obtained through investments and borrowings
4. Activities are regulated through market mechanisms
5. Rather well developed performance measurement and control systems

### **Performance Measures employed only in the Profit sector:**

1. Profit.
2. Economic Value Added (EVA)
3. Return on Investment (ROI)
4. Cash Flow from Operations (CFO)

### **Performance Measures employed mainly in the Non-profit sector:**

1. Evaluations
2. The Value Sieve
3. Peer Review

### **Performance Measures applicable to both sectors:**

1. Comparison against Standards
2. Benchmarking
3. Balanced Scorecard

### **Management Control Systems applicable to both sectors:**

1. Budget
2. The Accounting System
3. Auditing
4. Project Control
5. Information Reports
6. Performance Reports

## 6 Interviews with Managers in Non-profit Organizations

Originally, the interviews were designed in Questions-and-Answers style (Appendix 1), but given that, reading through the same questions repeatedly could be monotonous, all responses were transformed into a flowing text in order to make the present section more reader-friendly. The finished work was subsequently sent to the interviewees for their scrutiny and approval.

Although statistically valid conclusions cannot be based merely on this small sample of interviews, the aim is to identify the procedures that are typical for the non-profit sector and to provide the reader with a feel for the conditions and environments under which these organizations normally operate.

### 6.1 United Nations

#### **Presentation of the organization:**

The United Nations as a body is central to global efforts to solve problems that challenge humanity. The UN and its family of organizations work to promote respect for human rights, fight diseases, foster development, and reduce poverty and many more noble deeds. As a rule, consensus is reached through negotiations between the UN's member states. These negotiations result in conventions, declarations, action plans and resolutions. Cooperating in this effort are more than 30 affiliated organizations, known together as the UN system.

Expenditures of the UN system on operational activities, mostly on economic and social programmes to help the world's poorest countries, amount to some \$4 billion a year.

#### **6.1.1 UNRWA (UNITED NATIONS RELIEF AND WORKS AGENCY FOR PALESTINE REFUGEES IN THE NEAR EAST)**

UNRWA is the main UN Agency that works for Palestine refugees. By mandate, it provides shelter and emergency relief, basic health care and basic schooling to eligible refugees and their descendants. The organization's operations are financed almost entirely by voluntary contributions from governments and the European Union, which account for 95% of all the income. The other 5% is provided by other United Nations bodies and mainly covers some of the agency's staffing costs.

The organization provides for about 4 million refugees whose number grows by approximately 3.5 % annually. For the year 2001 donations amounted to \$310 million. Most of the contributions were received in cash, although some 7% of the income was received in kind, mainly as EU donations of food commodities for distribution to hardship cases.

**Interview Respondent:**

Mr. Aidan Walsh, UN Headquarters Personnel Consultant, and previous Director of Administration & Human Resources, UNRWA Headquarters Gaza

- Responsible for designing and implementing surveys/comparisons for salaries and working conditions for 22,000 staff in six countries.
- Supervising/overseeing recruitment, appointments, staff promotions, and benchmarking rates of pay in accordance with job specifications.
- Member of HQ UN Job Classification Committee and Consultative Committee for Administrative Questions.

Our organization's goal is peacekeeping in the Near East, through assistance to Palestinian refugees by providing Relief & Social Services, Health Care, Housing and Education. In effect all that would usually be done by a government in a European country. In order to achieve this goal, different departments of the organization provide specialized services to help the refugee families. To provide a clear example, our units' operations can be summarized as:

**Relief & Social Services:**

- Distribution of food rations to special hardship cases, cash assistance to destitute and sheltering the homeless.
- Providing assistance to the refugees to help themselves, through establishment of women's program centers, community rehabilitation centers and youth activity centers.

**Health Care services:**

UNRWA's health programme focuses on comprehensive preventive and primary health care. Services covering medical care, family health, disease control and prevention, and health education are provided directly and at no cost to Palestine refugees through the Agency's network of 123 primary health care facilities located both inside and outside refugee camps.

**Education:**

- Providing primary and secondary schooling free of charge to all eligible refugee children.
- Vocational and technical training courses.
- Extensive teacher-training programmes.
- University scholarships to qualified refugee youth.

As Director of Human Resources, I established the following objectives for my department:

- Optimising the use of the available resources, conducive with the parameters of the available funds.
- Recruiting competent staff to be appointed to appropriate locations and functions in a fashion which allows them to be part of an effective team. As far as possible those recruited should be refugees themselves.
- To train specialized staff in the techniques required, for example remuneration specialization and recruitment.

To facilitate the achievement of these objectives I provided my staff with detailed instruction manuals, personnel directives, administration instructions and arranged training courses for them in order to guide and coach them to recruit the most competent candidates (as long as UN limitations allow it).

In spite of the provided guidance and training I found the level of competence in my department unsatisfactory. Competent staff are rare because of the lack of specialized technical experts and due to the fact that staff are not always appointed with strict adherence to the most desirable parameters. For internationally recruited staff there is an internal UN rule of “National Balance”, meaning that the international staff must be a cross section of the member states weighed with a formula calculated on the basis of their budget contributions, severely restricts the freedom of recruiting the best candidates for the jobs. Besides, in some cases, donor governments apply pressure. In fact, in some cases the donor contribution is conditioned upon the appointment of nationals of the donor country.

The reward for good performance is accelerated annual increments for above-average performance; also promotions can be seen as rewards in some cases. Penalties can include a delay of an annual increment for a whole year or for a shorter period. On rare occasions a serious misconduct could result in “dismissal in the interest of the Agency” or in some cases even in a “summary dismissal”.

On the financial side of the operations, in my department the budget determined how many new staff could be recruited, i.e. the available positions and pertaining salaries. It was also used as an overall measurement for comparison of the costs incurred, and accounting information is an essential part of salaries’ administration, as rates of pay are decided on the level of funding available.

The running information we needed to carry out our duties was collected mainly through regular reports on staff performance, attendance and leave records, regular reports on numbers of refugees in receipt of different services, and on regular reports on the activities of different centers.

In cases where operations did not flow smoothly, much subjective judgement needed to be applied. There were no established procedures to follow; it is up to the authorized decision-maker to assess the case on its own merits in order to take corrective action. I find this a clear weakness, not uncommon in a bureaucracy.

Outcomes of our operations cannot be evaluated in monetary terms. In general, evaluations are done through debriefing reports on the achievement of objectives on completion of projects, reports on individual staff performances, plus annual performance evaluation reports on each staff member with the supervisors’ personal comments.

### 6.1.2 UNRWA Field Office

The five Field Offices are UNRWA's regional units, which are in direct contact with the refugees, and also the various host governments or equivalent bodies. The Field Offices implement the Agency's policies and programmes, adapting them to local conditions and legislation. A Field Office typically has only a handful internationally recruited staff, the rest being locally recruited, usually Palestinian staff. Field Offices have limited access to resources outside the Agency budget, but administer sometimes specific projects funded by external donors, such as the upgrading of classrooms, illiteracy programs for women, *etc.*

#### **Interview Respondent:**

Mr. Mauno Silpala, Head of the Finance Department, Lebanon Field Office, Beirut

Responsible for all aspects of financial management within the operation of a Field Office:

- Financial planning,
- Budgeting,
- Payments,
- Cash Management, and
- Accounting.

The objectives of my department are to facilitate the financial aspects of the operations, exercise financial control and to provide transparent and accurate reporting to the stakeholders of the organization. I carry out my duties through timely and accurate performance of the functions, such as preparation of the budget, processing of payments, processing and distribution of the payroll to 2500 employees, distribution of small cash assistance payments to 10,000+ welfare recipients and recording all transactions in the FMS (the Agency-wide Financial Management System). I ensure that all of the activities of the Field Office are carried out within the approved budgets and prepare the accounts.

The budget is used as a control tool. Any expenditure can only be authorized if there is a budget allocation for it.

The needed information for my department's activities is collected from the "sponsoring" department's operational statistics. The Agency is in the process of enhancing its systems to more readily provide management information, as opposed to just financial information.

Performance measurement is carried out by monitoring whether mile posts, both in terms of activities as well as projected expenditure, are reached on a timely basis or not. On a more general level, the effectiveness of budgetary control can be judged by the number of over-expenditures budget/expenditure reviews reveal. For donor-funded projects, the Agency produces periodic progress reports and, ultimately, a completion report to the donor.

Unrests, blockades, strikes, *etc.*, can prevent work from being performed in the normal manner, necessitating changes. Shortfalls in funding can cause stoppages or slow-downs in procurement, delays in meeting salary and other commitments, even

lay-offs and cancellations of some parts of the operations. Under these circumstances, the corrective action could mean shifting resources from one area of activity to another. An unsuccessful project is on occasions simply discontinued. If continuing is a necessity, the direction of the activity can be re-evaluated and available resources re-allocated.

I find my staff competent and committed. Reward could be praising good performance and earning an extra annual increase in pay. Penalty could be withholding the annual increment in case of bad performance.

The Agency employs Key Performance Indicators (KPI) to evaluate the effectiveness of the Program Departments: Education, Health and Relief/Social Services. However, KPIs are currently not established for the support services, such as Finance.

In general, at completion of each project an overall evaluation needs to be carried out and the results submitted to UNRWA headquarters.

### **6.1.3 UNDP (United Nations Development Program)**

#### **Presentation of the organization:**

UNDP helps to build capacities for sustainable human development in over 150 countries and territories. Through its work, the organization is contributing in development cooperation to United Nations system partnerships aimed at furthering the four basic aims of the United Nations organization: peace and security; humanitarian assistance; development operations; and economic and social affairs.

The overarching objective of UNDP is the promotion of sustainable human development, that places people at the centre of the development process, and funds for this purpose come from the voluntary contributions of member states of the United Nations and affiliated agencies, who have committed themselves to providing approximately \$1 billion yearly to UNDP regular resources. Other funding arrangements, including cost-sharing, provide approximately \$1 billion in additional resources each year.

#### **Interview Respondent:**

Mr. Fritz Brenning, Head of Engineering Department, Damascus

Responsible for:

- Planning and executing UNDP sponsored construction projects,
- Inspecting proposed construction sites and reporting on their suitability,
- Preparing land surveys and soil tests and relevant reports,
- Organizing and supervising all construction and maintenance work in the field, and
- Providing technical briefing to donors.

My organization's goals are:

- To create an enabling environment for sustainable human development,
- To eradicate extreme poverty and reduce substantially overall poverty,

- To achieve gender equality and advance the status of women, especially through their own empowerment,
- To protect and regenerate the global environment and natural resource asset base for sustainable human development, and
- To prevent or reduce the incidence and impact of complex emergencies and natural, environmental, technological and other human induced disasters, and to accelerate the process of sustainable recovery.

The objectives of my department are spending the donation funds in the most effective way and avoiding delays in contract executions. In order to do the task, our projects are internally executed by site engineers and an office engineer. The site engineer is technically responsible for the execution while the office engineer monitors the project financially.

In my department we use the budget to a very high extent, regularly comparing set targets with results.

Accounting information is essential. Each project starts only if the financing is secured and after that, all incurred expenses are strictly recorded and monitored.

We prepare weekly and monthly progress reports on a regular basis which are submitted to the Resident Representative. In addition weekly meetings are held to discuss the project progress. Owing to all these precautionary measurements, we hardly ever need to take corrective actions, as any deviations from the original plans would be discovered immediately.

I cannot express the outcome of the operations in monetary terms. The way I see it, outcome is satisfactory if the construction project is up to the set standards and unsatisfactory if there are defects.

My staff is sufficient and highly qualified, but more and better training would allow them to achieve more and better results. In order to motivate my staff, I try to work the hardest to set an example for the rest. Since monetary rewards are not applicable I use words of praise to encourage good performance. The penalty can be a letter of reprimand.

It frequently happens that a donor specifically requests the funds to be used on special projects such as building of schools or hospitals. I do not consider this as external pressure.

Completed projects are evaluated on the basis of mandatory completion reports which contain all essential and relevant data on the cash flows, incurred expenses, completion time, reasons for delay (if applicable), *etc.*



## 6.2 The Red Cross

Organizationally the Red Cross comprises of national Red Cross/Red Crescent Societies, and the Red Cross/Red Crescent Federation, which is a separate entity from the International Red Cross Committee (ICRC, all-Swiss). Both organizations have their headquarters in Geneva and work closely together, with the Federation specializing in disaster relief and development projects and the Committee working more with human rights, prisoners, *etc.* The limits between the two are, however, not sharply defined.

Each year millions of vulnerable people, especially children, die unnecessarily of disease and malnutrition, because they lack access to basic healthcare and nutrition. The Red Cross is focusing its health response to this crisis in three areas: Combating Emerging and Re-emerging Diseases (HIV/AIDS and Tuberculosis), Maternal and Child Health and Emergency Health.

Furthermore, the organization's International Services assure that the Red Cross is ready to respond at a moment's notice when crisis strikes, helping the survivors of war, upheaval and natural disasters around the world. In times of desperate need the Red Cross brings assistance to those who have lost their homes and are without food to eat and clean water to drink.

Immediately following an international disaster, the Red Cross is in constant communication with the local national society to determine its capacity to help survivors. When appropriate, they send to the scene highly trained members of their International Response Teams that are composed of experts in logistics and procurement, telecommunication, disaster operations, family linking, public health and media relations. Upon arrival team members immediately begin to assist the local national society with assessing disaster needs and implementing relief services, such as procuring and distributing food, water, shelter and hygiene items. Examples of these aids are Hurricane Mitch, which devastated Central America; deadly earthquakes with registered magnitudes of 7.4 in Turkey and Colombia; flooding that washed away lives and possessions in China and other Asian countries; and the Kosovo crisis.

### **Interview Respondent:** (Telephone interview)

Mrs. Charlotte Petri Gornitzka, Under Secretary General, the Swedish Red Cross Society

#### Duties:

- Overall responsibility for all activities,
- Support function in areas of administration, human resources, IT and public relations, and
- Coaching and supporting local area chiefs.

#### Goals of my organization:

- To carry out a system of international relief,
- Mitigating the suffering caused by pestilence, famine, fire, floods and other great national calamities,
- To devise and carry out measures for preventing above-mentioned calamities,

- Provision of food assistance to survivors of natural disasters, war and economic collapses, and
- Developing the capacities of people to help themselves throughout the world.

Objectives of my department:

- To provide guidelines and assistance when/if possible to our 600 employees who work in 10 regional offices,
- To arrange training courses aimed at preparing selected personnel for international projects (ICRC/Federation operations),
- Fundraising, encouraging donors to be generous with their donations,
- Reducing the costs of operations, and
- Having satisfied clients (people we help).

In order to achieve these objectives, we start our operations with planning. Our policy evolves around vision and mission. We try to come up with clear goals first, which we then break down individually in a manner that each unit bears the responsibility for the special tasks assigned to it. We need to define what needs to be done so that our employees would know if they have succeeded in carrying out their duties. We lack clear indicators for the time being, but we are working on it, as the morale suffers under the present conditions.

The budget is very important in our operations. The annual budget is broken down for each department, and our managers are expected to adhere closely to their assigned budgets.

Accounting is an integrated part in our operations and is extensively used. As a rule, we have monthly debriefings on ongoing operations, and a controller/internal auditor is working closely with the management team.

Statistics are available for some but not all of our activities, for example, numerical information is available for our resource mobilization, but these numbers are by no means indicators of overall efficiency. However, we have follow ups on opinion ratings.

When it comes to the issue of external pressure, there are times that the donors stipulate how the money should be spent (specific projects); they also demand to receive reports on how the funds are used. Besides, the government has very lucid rules on how the funds should be spent and accounted for.

In general I consider our staff very capable but at the same time there is a need for improved managerial skills.

We do not have a formal reward system. I try to motivate my staff by holding regular meetings to emphasize the importance of our tasks. Not getting promotions would be the penalty for unsatisfactory performance.

Frequent project evaluations help us to identify the problem areas that need attention and implementation of corrective measures. Evaluations help us learn from committed mistakes. We also use mid-term evaluations for our long lasting (more than a year) projects.

## 6.3 Sida (Swedish International Development Cooperation Agency)

### **Presentation of the Organization:**

Sida is the Swedish government agency for bilateral international development cooperation and Sweden's cooperation with Central and Eastern Europe. In a broad-spectrum, Sweden participates through Sida in processes which involve the solution of global problems with the aim to reduce poverty, protect the environment, solve conflicts, reduce the gap between rich and poor countries, and many more areas, in order to lay the foundations for a better future for everybody.

Each year almost 300 Swedish non-governmental organisations (NGOs) receive government support for their development projects on the basis of the 80/20 principle: if the organisations can raise 20 per cent of the required funds, Sida can provide the remaining 80 per cent. In addition, much of the Swedish humanitarian assistance is channelled through Swedish NGOs; however, Sida does not require any funding by the NGOs for these types of contributions.

Furthermore, Sida's activities cover multilateral development cooperation. These activities are channelled via the Ministry of Foreign Affairs to a number of multilateral organizations, mainly UN agencies, the World Bank group and the EU, and funding is provided in the form of core contributions for regular operations and financial assistance for special projects.

### **Interview Respondent:**

Mr. Sten Ström, Senior Adviser, Public Financial Management in Development Cooperation, Cooperation with former Eastern Europe, Sida's own Internal Management, and Internal Audit

Reducing poverty is the dominant goal of all Sida's operations, and to provide guidance for our projects for the reduction of poverty the Swedish parliament has laid down six goals for Swedish Development Cooperation: Economic growth, Economic and social equality, Economic and political independence, Democratic development, Environmental equality, and Equality between women and men

We have a great variety of projects and programs, ranging from relief services to long-term support for political processes. Normally, our projects are prepared according to the Logical Framework Approach, stating development goals, objectives, outputs, activities and resources, verifiable indicators with time limits, and risk factors. The progress of each project is measured against this LFA matrix, both in current reporting during the implementation and in final reports including subsequent evaluations (sometimes, mid-term evaluations are also made).

The function of the budget in our operations is to forecast and monitor administration costs and to allocate resources for each project, where detailed amounts are worked out on the basis of appropriation figures (amounts set aside for specific purposes/projects) all the way down to the sub-project level.

Accounting information is used extensively in our operations. Details of financial aspects of projects and programs, accompanied by available statistics, are recorded in our accounting system according to OECD DAC requirements (domestic follow up

reporting requirements decided by the Government and based on the internal needs of the organization). All transactions are related to the unique project identity and every project must be followed up monthly. There are areas not suitable for this (mainly admin) but this is the general rule. Available financial resources are allocated to different units in the organization, and individuals with the right to use the funds are the ones responsible for the follow-ups.

At higher levels in the organisation, aggregated accounting information and forecasts are used for reallocations. Sida is accountable to the Government, and submits semi- and annual reports that are subjected to external audit. On a monthly basis, accounting information is transferred electronically to SNFMA (ESV) to be aggregated for the whole government. The aggregated accounting information is ultimately used by top management deciding on overall allocation of funds

To measure and monitor performance, necessary information for on-going projects is collected through monthly financial reports, substance reports (how operations are conducted and progress), and meetings and debriefings with project managers and counter-parts. For certain areas there are recommended Standard Templates (a standard form with required information already printed on it so that the user only needs to fill in the blanks, or a standard format that has given headlines/questions that should be elaborated upon).

On occasions where mid-term evaluations indicate deviations from original plans an attempt is made to determine the causes, in order to concentrate on problem areas that demand improvement so as to remedy the situation. In general, when projects are considered to have gone astray, corrective actions start with a meeting and discussion with the concerned counter-part to find out what has gone wrong and why. In cases of misuse of provided resources Sida disrupts further payments and reserves the right to demand reimbursement (though this rarely happens).

Quantifiable data available for our operations are different kinds of statistics. On a project basis the verifiable indicators in the LFA matrix are of quantitative nature. However, these figures indicate only the inputs, output of projects concerning areas such as democratic development in society or the long-term sustainable use of natural resources cannot be measured in monetary terms.

Sida is run through parliamentary and governmental rules, and sometimes political pressures confront our professional judgment, and at times political pressure in co-operating countries may be strong. The situation varies.

In my opinion, staff competence in our organization is generally high, but things could always be better... On the other hand, our staff is very committed, and interesting tasks and much responsibility are commonly considered more important than a good pay. There is no formal reward or penalty system in use but, possibly, short or long term assignments abroad could be perceived as a reward and not getting a promotion as penalty for sub-standard performance.

Apart from audit, our projects are often evaluated by external or internal experts (consultants, internal evaluation and audit department *etc.*), unless they are small and

insignificant. NGOs are often subjected to a "systems audit" (at least larger Swedish NGOs) by us.

The department for Evaluation and Internal Audit reports directly to Sida's board. It has the overall responsibility for evaluations at Sida. It examines and makes assessments of the appropriateness of the agency's internal controls, efficiency and security and, in due course, the results of these evaluations are reported in the Annual Reports.

## 6.4 Save the Children

### **Presentation of the organization:**

Today, 128 million children in the world have no school to attend and education systems throughout the world are greatly challenged. Millions of children are either left unattended or are in situations of low-quality child care while their mothers work. The cornerstone of all Save the Children's programs is to ensure self-sufficiency for families through utilization of a broad array of strategies and application of new approaches in child development and basic education around the world. One such approach is working with families to define and try to solve the problems their children and the concerned community as a whole are experiencing.

Through the decades, the organization has evolved into a leading international relief and development organization in 47 countries in the developing world, to help children and families improve their health, education and economic opportunities. In addition, rapid life-support assistance is mobilized for children and families caught in the tragedies of natural and man-made disasters.

### **Interview Respondent:**

Mr. Michael Ekström, Member of the Secretary General's Management Team "planning unit".

Responsible for:

- Supporting the Secretary General on all matters concerning the governing of the organization,
- Administration of organization's procedures, directives, instructions, *etc.*, and
- Strategic planning, follow-ups and evaluations

My organization's goals can be portrayed as:

- To protect children from discrimination, exploitation, violence and other kinds of abuse,
- To ensure a safe and healthy upbringing for all children,
- To provide support and assistance to civil societies active in children's issues to promote children's rights,
- To induce extensive media coverage to bring children's appeals to public's attention, and
- To influence the decision-makers and authorities to take children's rights into account in their policy makings and resource allocations.

My department's objectives are to formulate directives, instructions and manuals for executing and monitoring our programs, to increase the general staff competence in planning, executing, follow-up and evaluation of programs, and at the moment, striving to develop an effective reporting and evaluation system.

For us the budget is a means to direct resources, and emphasizes the priorities in general. In the planning stage, when distribution of available resources are discussed, the head of the program department presents his/her proposals to the Secretary General. The board of directors decides on certain key figures, *i.e.* for the

core activities (66% of total expenditure), and the Secretary General distributes the available resources on a more detailed level among different units and departments. Then, according to budget figures, during the year follow-ups are carried out.

Accounting information is always present in our operations, but many experience this information as rather incomprehensible and meaningless. The challenge is about connecting the figures to strategies, work-flows, achievements and methods.

Regarding the issue “*how* performance should be measured?” we feel a strong need to develop the skills, but at the same time we understand that this is a very tricky matter for many organisations of our kind. For this purpose, our offices abroad have routines for monitoring our partners’ work and our partners are requested to submit reports during the year, but no standard is set for the reports. We talk rather frequently about the need of indicators (we try to work according to the Logical Framework Approach, LFA), but progress is rather slow. Furthermore, we try to define what a project is and how to break down a project into meaningful parts, all in order to be able to allocate the appropriate costs for different elements involved in a project, and in order to be able to cross examine expenditures, methods and effects.

In my department, as we meet frequently and discussions are permanently going on, we have the possibility to change tactics or working methods rather smoothly, in case things go off-course.

When it comes to the organization as a whole we still lack effective means of assessing the outcome of the activities, especially in relation to inputs. The Secretary General meets once a week with the Department heads and (some) units. These discussions result to some extent in “corrective actions” in the short-term perspective. Special talks (follow-ups) are held every four months dealing with the programs for the year. We put an emphasis on learning from our mistakes when re-writing project agreements or withdrawing funds.

The only part of the organisation’s work that can be measured in monetary terms is the fund-raising activities, it is rather difficult to use quantitative measurements for the other ones. This issue also depends on how you interpret “outcome”. During our efforts to deal with this challenge we try to make a distinction between “results” and “effects”. With “results” (corresponding to production/performance goals) we mean what we actually “produce” or get done, “effects” being what might happen as a result of our operations. For example, we may produce and realize a campaign (= result). If this campaign changes anything, or contributes to a change, that would be the “effect”.

Constraints can be imposed by donors when they distinctively “ earmark” donated money. This happens mostly when it comes to disasters of different kinds or as an effect of intense media coverage on a certain issue. It sometimes creates “problems” if the organization doesn’t have a program going on in a certain geographic area or on a certain issue. Additionally, Sida exerts strong pressure on us to better account for the effects of our activities.

I find our staff very committed, hard-working, and competent. Altogether, we all have a long and broad experience from the organisation. I feel that we have a

relevant academic training. In spite of all this, I think we still need to develop many skills ...

There is no explicit reward or penalty system in use. Maybe no need is felt because the staff is highly committed.

Evaluations are used as a tool for monitoring programs' progress. When it comes to our (core) programs evaluations are executed to a high extent on a regional/country level. Other evaluations are initiated from HQ. This is not yet systemized and you could say, from a general governing perspective, that this is done very much in an *ad hoc* way. The work on a more kept-together and strategic plan of evaluations has just been initiated.



## 6.5 Individuell Människohjälp – IM

### **Presentation of the organization:**

IM is a Swedish development assistance organization whose activities are based on the UN Declaration of Human Rights stating that “All people are equal in dignity.” The organization operates in some twenty countries throughout the world, providing education, health and income-generating projects in order to improve people’s conditions of life and to strengthen their individual rights. Restoring human dignity is a major driving force behind the organization’s activities, which start on a small scale and develop with the aim that they should be taken over by local co-operation partners.

IM strives to change attitudes to mentally retarded and disabled people in order to integrate people with disabilities in the community by showing that they also have a right to be seen and to develop their skills. A result has been improvements in Romania where children, who had previously been regarded as mentally retarded and lived at state orphanages, now attend ordinary schools and live in group accommodations or have moved home to their families. For those with disabilities, this is a big step towards greater independence and a dignified life.

### **Interview Respondent:** (Personal interview)

Mr. Janusz Lipinski, Project Organizer, Responsible for operations in India, Nepal and Tibet, and Contact person between the Swedish head office and local partners  
My organization’s goals are:

- Reduce poverty
- Provide health care
- Provide schooling
- Provide assistance to handicapped and mentally retarded
- Help people help themselves

Areas of my responsibility: In India and Nepal we are working together with local partners to provide those suffering from leprosy with treatment, and we have also built a hospital for those suffering from tuberculosis. In the same country, during the monsoon season, in the districts where we have on-going projects, some areas went under water recently and for that reason, we started a rehabilitation project for cyclone victims.

In Nepal, our on-going project is to provide health care and education for women in 8 slum areas. For this purpose a trained nurse and 8 health workers live in those slums so as to be available to the people when needed. Educational programs for women include classes on the use of herbal plants for the treatment of various diseases. In a way, this can be considered a kind of women empowerment related programme.

In Tibet: the aftermath of the Chinese occupation of Tibet and new contact with the Indian subcontinent in the south, has been a disintegration of local ethnic traditions, as a result of which people have slowly begun to lose their identity. The decline is so great that today very few people under the age of 25 can read or write their own language. The local people themselves have also become aware of the fact that unless something is done to preserve their identity and culture it will be lost forever in

the next generation. In order to remedy the situation, a new two-year project to train 25 young persons coming from a cross section of ethnic groups living across the Himalayas has started. After the completion of two years, these trained graduates will return to their respective areas and teach in monasteries, institutions and schools. The actual need is much greater but this is a pioneer effort to start restoration of a culture in decline.

We execute these projects bilaterally in cooperation with local partners. The normal procedure to commence a new project is through a formal request sent to me by some local authority or organization. It is up to me to first carry out a feasibility study to determine whether we have the necessary resources to provide the assistance and then to assess in what ways the proposed project would benefit the target group directly and the rest of the community indirectly.

In many cases we implement income-generating projects, that is, activities that will pay for themselves. These initiatives start on a small scale and then develop step by step to be handed over to the local cooperation partner, for example, loans and assistance are given to individuals to start a bakery, taking care of livestock, plantations or small workshops.

The budget is used as a control device on a large scale mainly in order to monitor the incurred expenses and to verify variances.

I find accounting information vital in my work, at the end of each month I inspect all the provided statements thoroughly.

For me the best way to measure performance is to use various indicators and compare the actual figures presented to me with the budget.

In case a project does not progress as was originally planned, I re-evaluate the project, taking changed conditions that might have caused the deviations into consideration. In order to do this I travel to the location myself or the local partner in charge of the project travels to Sweden, to have meetings and discussions. If things cannot be remedied with small modifications we might need to start the project all over again. In that case a complete report needs to be sent to the top management to ask for their approval.

I cannot express the outcome of the projects under my supervision in monetary terms. The best I can do is to provide statistics.

I find our staff competent and dedicated. There is no established reward system at work. Penalties can be official warnings and eventual dismissal.

External pressures that I can think of are the occasions where donors request execution of special projects for the donated funds.

After completion of our projects I need to evaluate the project and send a formal report to my chief, and all the reports ultimately end up with the Board.

## 6.6 Summary

### **Organizational goals & Departmental goals:**

In all organizations the objectives of the organization and interviewees' departments are clear, concrete and well-defined.

### **Budget Employment:**

The budget seems to be the most important tool in performance evaluation, which is used for guidance, monitoring and control.

### **Application of Accounting Information:**

Accounting information is considered absolutely essential, even though on occasions it can be perceived as meaningless and incomprehensible by some staff. Nevertheless, projects cannot be executed and monitored without taking the financial aspects, to an extensive extent, into consideration.

### **Data Collection Techniques:**

The usual procedure is through different kinds of regular reports on both financial and non-financial aspects of the projects, statistics, mid-term evaluations, discussions and meetings.

### **Performance Measurement techniques:**

During the period of actual operations managers monitor the goings-on, based on regular reports presented to them, and compare the results with some kind of standards, a pre-determined budget, and/or non-financial elements affecting the outcomes.

### **Techniques available to take corrective actions to steer operations back on Track:**

Taking corrective action is based on monitoring the performed procedures, pinpointing the deviations, establishing reasons for discrepancies and then trying to come up with appropriate solutions.

The normal procedure is "bottom-up". It is up to managers at lower levels to make the initial assessments; results are reported higher up in the hierarchy. Approval for making changes for the whole project needs to come from the top management.

Corrective action can be in the form of project-prolongation, extra money or manpower injected into the project, continuation of an on-going project with a follow-up project or, under drastic circumstances, to re-design the whole project and start all over again.

### **Possibility to quantify results of operations:**

In general, it is not possible to assign numbers to the outcomes of operations.

### **External pressure:**

All responded that it is real and definitely present.

**State of sufficiently qualified personnel:**

All respondents except one, stated that staff in general were satisfactory and committed.

**Rewards and Penalties:**

On the whole, there is no established reward system, but penalty systems exist.

**Evaluations:**

Evaluations are used both as a tool to monitor the progress of operations in order to take corrective action if needed and as post-action control, which sets precedent for the future to learn from the mistakes.

## 7 Conclusions

Based on the interview responses from decision-makers in non-profit organizations, presented in the previous section, and my own personal observations, my conclusions are as follows:

### *Goals & Objectives:*

Since in charitable non-profit organizations goals are clear, concrete and well-defined, it is possible and rather uncomplicated to develop appropriate and relevant procedures to attain the goals. It seems that the planning and strategy formulation process runs smoothly in these organizations.

### *Budget:*

Budget application in non-profit organizations appears to be much more intense in comparison to the profit-oriented corporations, and in the budget itself, items of expenditure are the most important figures. By and large, budget is mainly used as a control device where figures lead the way in the operating procedures, and managers are not authorized to spend more than the allocated amounts unless there are compelling justifications. Even under special circumstances they still need top management's approval before the actual spending.

### *Statistics:*

Inputs of operations can be measured accurately, but the only possibility to quantify outputs is through providing statistics. However, statistical figures are not representative of the quality of actual services performed; therefore, good or poor result can be indicated by comparison between the set objectives and accomplished tasks. A clarifying example could be: if the objective was to accommodate 1000 homeless and only 600 shelters were constructed, that is an indication of poor performance. On the other hand, if using the same budget and resources, 1200 shelters were built that shows good performance.

### *External Pressure:*

External pressures exerted by donors or governments, although harmless on some occasions, can hinder effective performance, the most efficient application of resources, and recruitment of the most suitable candidates.

### *Rewards & Penalties:*

Non-profit organizations lack established reward systems but penalty systems are present, which leads one to conclude that instead of attempting to motivate the employees through encouragement, the system is devised to deter the undesired behavior through discouragement.

All study units in this paper have been large multinational organizations with a large number of staff; this means that the majority of employees would be non-professionals, performing clerical or other routine tasks. Dedication and high motivation among professionals and managerial staff can be justified, but lack of some kind of positive incentive for the rest of the staff is certainly a weak point that needs to be addressed in the non-profit sector.

In order to deal with this problem, the interviewed managers had used their own initiative and judgment to motivate their staff either through words of praise or setting motivating examples through working the hardest themselves.

### *Performance Measurement*

#### *Measurement Process:*

In practice, *scaling* is widely in use:

- When different programs are given names the Nominal Scale is in use; for example, “Women’s Training Program” distinguishes the whole relating projects from “Special Hardship Cases”.
- When the performance of the “Women’s Training Program” is compared with what the results had been the previous year, one uses the Ordinal Scale, which shows whether a performance has been better or worse.
- When the same program is compared within different time frames, for example, as we say: when we started this program 5 years ago, the number of illiterate women who graduated after the training were only 800, but at present the number has risen to 2000, the Interval Scale is used.
- When we simply state the number of graduates from the program, the Ratio Scale is in use.

#### *Measurement Categories:*

Accounting information embraces all characteristics defined in Fundamental, Derived and Fiat measurements.

#### *Meaningfulness:*

Accounting is usually the common language for measurement through the whole organization, but to describe how operations are running, different departments tend to develop their own special terms and vocabulary, which do not make much sense to outsiders. An example: in UNRWA Gaza, the Supply and Transport Department had come up with its own terms and measurements to depict the number of punctured tyres in a day (due to the many nails and barricades in the streets set out by Palestinian youngsters) and also the number of smashed car windows that needed to be replaced after stone-throwing incidents.

*Reliability & Validity:*

In the United Nations, the ongoing practice to evaluate employees' performances is through Annual Performance Report forms, filled in unilaterally by the immediate and secondary supervisors on how the staff has performed during the year. The form comprises of standard sections with multiple-choice alternatives for outstanding, excellent, good, average or poor performance; with space provided for the supervisor to write down his/her personal observations and comments. After this section, follows another section where the observed employee is given the chance to agree with the evaluation or rebut, if not. These reports weigh heavily and can be decisive, when the concerned employee is due to get promotions.

To me this measurement lacks suitable validity and reliability to provide the grounds on which an employee should be promoted or not, because there are occasions where the personal chemistry between the supervisor and the subordinate is not right, and personal clashes can lead to getting unsatisfactory remarks. In my opinion, it would be more reasonable if the procedure was established on a bi-lateral basis, where the subordinates would be provided with an equal chance to judge and appraise the "bosses" performance, as well.

*Commensurable & Incommensurable Measures:*

When allocating the available sums to different projects, managers in the non-profit sector are faced with the difficult task of using incommensurable measures, comparing apples with oranges, in order to make their decisions. It is difficult to justify if the money is put to a better use when it is spent on expanding the Vocational and Technical Training courses, or on upgrading activities in Community Rehabilitation Centres, or on increasing the medical staff in the Primary Health Care, or on hiring more sanitation workers.

All these programs are required, but each makes a different kind of contribution to the society as a whole, and the output of one project cannot be compared with the output of another.

*Measurement Dysfunction:*

Several interviewees have stated that providers of funds require reports to know how the funds have been utilized. An example where a measurement dysfunction can manifest itself, could be our UNDP interviewee Mr. Brenning, a construction engineer, providing his report on how construction operations have been accomplished. The technical jargon, which is an essential part of conveying information in his job, would most likely not make much sense to the ambassador of the donor country; therefore, Mr. Brenning (the Agent) needs to simplify his report and try to use common terms as much as possible to make the information comprehensible for the donor (the Principal).

*Accountability:*

Accountability, which is defined as the foundation of performance measurement, needs at least two parties involved:

1. One who allocates responsibilities: in case of the United Nations → The General Assembly, Sida → The Swedish Parliament, Save the Children → The Board of Directors.
2. One who accepts the allocated responsibilities: Top level management.

*Procedural Accountability:*

Deals with Revenue & Expense Side of Financial Statements:

1. Common expectations → Complete and accurate financial statements
2. Shared language → Financial
3. Shared standards → GAAP

Top management bears the ultimate responsibility for presenting the organizations reports, and if there are discrepancies in presented financial statements, the ultimate responsibility lies with the top management, although it is an employee who has made the mistake either intentionally (theft) or unintentionally (ignorance or carelessness).

*Consequential Accountability & Value for Money:*

Financial statements in the non-profit sector meet the requirements of procedural accountability but they say nothing about consequential accountability, which deals with efficiency and effectiveness. In order to remedy the situation it is suggested that the Value for Money concept can be employed; a notion suggesting that focusing on measures of resource utilization and measures of attainment of intended results would indicate both efficiency and effectiveness. Here, we are going to have a closer look at the components of the equation:

$$\text{VfM} = \text{Anticipated Outcomes} / \text{Required Resources}$$

“Required Resources” deals with the use of financial, human and material resources needed to provide the services. As an example, if we have had a training course in sewing for women with the objective to teach them a trade that enables them to earn a living for themselves and their families, with the anticipation of having 30 graduates at the end of the course, the information on financial side could be as follows:

1. Money spent on the course → \$10,000
2. Number of needed employees → 3 Instructors
3. Employed material → 30 sewing machines and 3000 meters of fabric
4. Man-hour spent on the job → 72 hours by each instructor

But at the end of the course the result shows that only 15 women managed to complete the course and graduate. The rest of them had to stay home to take care of their sick children or had other hindrances. Consequently, the anticipated outcome is diminished by half, which is a clear indication of loss of VfM and inefficiency and ineffectiveness of the undertaken project.



Although in the theory part Value for Money (VfM), is presented as the surrogate for profit, in reality the procedure was not applied in any of the interviewed organizations.

*The Value Sieve:*

The value Sieve, which is a choice prioritization process, compels the decision-makers to choose among incommensurable alternatives, for example to decide whether the money at hand should be spent on Relief Services, Health Services or Education. All of these projects help the community a great deal, but in different ways.

This procedure, although it was not named “The Value Sieve”, was put into practice by UNRWA in the Occupied Territories (Gaza Strip and West Bank) when the *Intifada* (the uprising) started, forcing the Agency to prioritize its normal operations. As a result, it was decided that budget re-allocations had to be shared among all the Agency’s Fields, although for political reasons it was not possible to cut back as much as would have been fair in the Syrian and Jordanian operations (a clear case where external pressure interferes with the most efficient way of running the operations); low-priority welfare projects such as women’s programs were discontinued, and maintenance of premises was postponed. On the other hand, the budget for Health Services, the need for which had dramatically risen, was increased and a new major hospital was built in the Gaza Strip.

*Benchmarking:*

“Organizations can obtain an understanding of the weak and strong points of their operations through benchmarking (comparing) their activities with those of other relevant organizations.” Benchmarking in the non-profit sector can be a practical procedure to follow in order to learn from experiences of other organizations with a similar agenda in the field.

In the interview section, Mr. Ekström from Save the Children states, “ We talk rather frequently about the need for indicators (we try to work according to the Logical Framework Approach, LFA), but progress is rather slow.”

On the other hand, Mr. Ström from Sida maintains, “Normally, our projects are prepared according to the Logical Framework Approach, stating development goals, objectives, outputs, activities and resources, verifiable indicators with time limits, and risk factors. The progress of each project is measured against this LFA matrix, both in current reporting during the implementation and in final reports including subsequent evaluations.”

In my opinion, Mr. Ekström can simply find out which organizations in the Field use the LFA system (can easily be done by asking around), and to contact a counterpart in that organization to arrange meetings and discussions to learn from their experiences.

## *Management Control Systems*

Management control processes in all investigated organizations shared four basic procedures:

1. To carry out the control process, managers obtained an ongoing flow of information through different types of reports prepared regularly. This practice kept managers well-informed of both the positive and negative developments and provided them with the opportunity to take timely corrective actions when needed.
2. Accurate information on the quantity of available resources was collected before starting the operations, and then estimates and decisions about the desired level of outputs were made.
3. During operations, actual work in progress was monitored through maintained records on consumed resources and produced outcomes.
4. After completion of projects, evaluations were made.

It appears that managers drawing on their knowledge and past experience take many, if not most, of the operational decisions. Therefore, the skills and personalities of these managers can be crucial to the success of the projects. It follows that a successful manager is the one who has first-hand field experience, and is not afraid to improvise, should conditions change.

As all respondents (except one – due to UN constraints)<sup>106</sup> were satisfied with the level of competence and commitment of general staff, Ouchi's theory that "non-profit organizations rely heavily on strict selection procedures while recruiting candidates, in order to increase the possibility that the future employees would be able and committed individuals who will meet the high standards of desirable performance"<sup>107</sup> seems to hold.

In my opinion, Hofstede's approach to management control where he puts the emphasis on the human side of operations stating "employees are the main reason for organization's success or failure" only applies to the non-profit sector; as in the private sector many other factors such as the economic situation as a whole, a high level of inflation, rates of exchange, new governmental regulations, new taxes, etc., can affect the outcome of operations, no matter how outstandingly an organization's employees perform their duties.

Ouchie's Market mechanism obviously does not apply to the non-profit sector, but his arguments concerning Bureaucratic and Clan mechanisms are convincing. I find that

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<sup>106</sup> This thesis, p. 47.

<sup>107</sup> This thesis, p. 21.

the Bureaucratic mechanism is the dominant control system in non-profit organizations as, in these organizations, “Rules” that are incorporated in directives, manuals and instructions lead the way on how duties must be performed.

The group pressure can be strong in charitable non-profit organizations, as those who are there “just to have a job” with no deep commitment to the cause are easily recognized, and can be “frozen out” by the rest, more committed members of the organization. On the other hand, the dedicated and enthusiastic members easily gain the respect of others through their devotion to the cause. Therefore, characteristics of sharing common values and objectives, striving to achieve a common goal (to help the less privileged), signify the Clan form of control, which affects the behavior of the employees.

In general, the bulk of the investigated theories indicates that the management control process has some shared principles and a basic rationale, that is, “assuring what is intended is obtained by exercising corrective actions when deviations occur.” However, in spite of these common traits, the application of the whole control process depends on prevailing situations and circumstances governing each particular organization. An exclusive and supreme control system fitting all types of organizations and appropriate for all situations and conditions does not exist. Different methods and techniques need to be used in different organizations consistent with the unique circumstances prevailing in the concerned organization.

### *Profit & Evaluation:*

Profit is a measure of performance that provides the sought-after information about efficiency and effectiveness through an equation ( $\text{Revenues} - \text{Expenses} = \text{profit}$ ). A simple procedure is followed for obtaining this measure, that is, both expense and revenue figures for all departments and operations are registered through the year by clerical staff. At the year-end, adjustments such as depreciation, advanced payments, prepaid expenses and accrued income, are made by accountants in order to come up with the profit figure.

It should be noted that the profit figure by itself is just a number like any other number and does not say anything about an organization’s efficiency or effectiveness, it is when this figure is compared to a variety of factors that the necessary information is provided. For example, when we say that a company has had a profit of one million dollars, the statement by itself is insufficient to determine how well the organization has done. As with an investment of \$100 M, the profit of 1 million (1%) is indicative of poor performance, whereas with an investment of \$10 million (10%), a profit of 1 million is indicative of good performance, and with an investment of \$5 million a profit of 1 million (20%), is indicative of an outstanding and above-average performance.

In order to find out about efficiency and effectiveness of operations in the non-profit sector the more complicated procedure of Evaluation is employed. In this process decision-makers need to compare the results of operations with some pre-established standards:

- If the project has achieved what it was supposed to the end result would be marked “On target”, indicating that operations have run smoothly and estimations have been accurate and realistic;
- If the output is less than what was originally anticipated, the situation calls for an analysis to determine the reasons for deviations and the operation is marked as inefficient and ineffective;
- If the output happens to surpass the expectations, again an analysis is needed to find out the influential factors affecting the achievement of superior results.

As a clarifying example we assume that with a budget of one million dollars we intend to build shelters for 100 refugee families in the Gaza Strip. After the completion of the project, during the evaluation phase, several scenarios can be envisioned which would be demonstrative of how efficiently or effectively the project has been accomplished:

Efficiency: represents the relationship between inputs and outputs

<u>Input</u>	<u>Output</u>
1M \$	50 shelters are built - Inefficient
1M \$	100 shelters are built - On target
1M \$	110 shelters are built - Efficient

Effectiveness: relationship between objectives and end results

<u>Objective</u>	<u>End result</u>
Build 100 shelters	50 shelters are built - Ineffective
Build 100 shelters	100 shelters are built - On target
Build 100 shelters	110 shelters are built – Effective

However, in contrast to profit figures, which provide easy to grasp and concentrated information, here the results, reasons for deviations and different influential factors need to be analyzed and explained with words.

Appraisals made on actual performance and obtained results are the overall performance indicators for the organizations’ decision-makers, demonstrating how well the intended objectives have been achieved. They pave the way for a continuation of the current methods if performance has been satisfactory; or, if performance has been unsatisfactory, can lead to an alteration of the applied techniques in implementing strategies.

Moreover, if results reveal that the estimated budget figures have been unrealistic, it is an indication that managers need to look for more reliable sources of information, in order to obtain more accurate approximations for future use.

## Appendix (1) – Interview Questions

1. What is your job description? What is it precisely that you do?
2. What are the goals for your organization?
3. What are the objectives of your department?
4. What specific resources do you have at your disposal to carry out your duties?
5. Taking resources on hand into consideration, what do you consider to be satisfactory outcomes of the programs under your supervision?
6. How do you compare actual outcomes of your performance with anticipated ones?
7. What corrective actions can you take when there are deviations?
8. To what extent do you use accounting information?
9. To what extent do you use budget as a control instrument?
10. Can the outcome of your work be quantified? Measured in monetary terms? If not how do you measure the actual performance?
11. What project evaluation procedures do you use?
12. How is the required data for this purpose collected?
13. Are there any standing procedures/instructions on how performance should be measured?
14. Are there any standard reports that have to be submitted at regular intervals or upon completion of a specific task?
15. Which means and methods are at your disposal to monitor the progress of the programme or project?
16. Do you have sufficient and competent staff in your department?
17. Are there any constraints imposed by donors, political pressure from local governments or internal rules, such as observance of “national balance quotas”?
18. How do you motivate your subordinates to perform their best? What are rewards for satisfactory performance and penalties for unsatisfactory work?
19. Is it possible to change programmes or tasks if conditions change, *e.g.* by shortfalls in funding, unrest, *etc.*? How?
20. When a project is evaluated as unsuccessful, what procedures are at your disposal to improve the situation and set things right?

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