

FAQ: What is a Balanced Scorecard Audit?

In 100 words...

A **Balanced Scorecard Audit** is a structured review of both the **content** and the **usage** of an organisation's Balanced Scorecard. An audit is an evaluation to ascertain the validity and reliability of the information it produces, (the **content** of the Balanced Scorecard), and to assess how effective they tool is in helping the organisation accomplish specific goals or objectives (the **usage** of the Balanced Scorecard). Currently there are no independent external requirements (standards) against which a Balanced Scorecard can be assessed (as exist for financial audits, for example), and so Balanced Scorecard audits generally refer to non-statutory 'best-practice' guidelines. [For more on best-practice this, see the 2GC FAQ: "What is the 'state-of-the-art' in Balanced Scorecard design?"]

Audit objectives and criteria: where to start?

Organisations use Balanced Scorecards for a range of purposes. The two most common are 'performance reporting' (generating and distributing historical performance information) and 'performance management' (acting on the performance information in support of improved future performance).

- *Because Balanced Scorecards are used for different purposes, it is important to understand and agree the purpose of a Balanced Scorecard before starting an audit: the purpose will determine the criteria against which its contents and usage effectiveness will be evaluated.*

When a Balanced Scorecard is used primarily for **performance reporting**, an organisation (or sub-unit) collects and reports on performance using measures chosen by others – who usually use this information to evaluate performance in some past period. This information needs to be 'accurate' – and often ensuring accuracy can result in delays in reporting the data.

- *Usually the information is reviewed by the sending organisation, but since the measures are chosen elsewhere, the sending organisation typically does not directly influence the management agenda. In these cases, a 'good' Balanced Scorecard is one that accurately reports the information chosen by the receiving party, and so the auditor needs to focus on understanding the accuracy of this information.*

Balanced Scorecards used for **performance management** purposes help management teams to track their progress in implementing strategy: in essence, whether their chosen priority strategic activities are being carried out, and whether they are having the impact expected. Here, the requirement is for the Balanced Scorecard to inform management decision-making on corrective interventions – if something planned is not being done, or not working, the management team need to do something about it.

- *A useful Balanced Scorecard of this type needs to provide timely and relevant performance information as defined by the management team itself. In these cases, the auditor needs to understand the informational requirements of management (i.e. who needs to know what, when and why?), in order to assess the relevance, usefulness and timeliness of the performance data being reported.*

These differences illustrate the importance of agreeing the intended purpose of the Balanced Scorecard before defining and agreeing the audit objectives, scope, criteria and methodology. Agreeing these in advance makes it more likely that the audit findings will be accepted, and that audit recommendations will be implemented – the ultimate test of an audit's value.

Objectives and criteria: strategy and strategic objectives

Balanced Scorecards intended for **strategic performance management** purposes must reflect the strategy of the organisation. An audit of this type of Balanced Scorecard audit must therefore consider the clarity with which the strategy is documented, the effectiveness with which it is communicated and the impact this has had on the quality of objectives chosen for the Balanced Scorecard. In doing this, however, it is important not to get side-tracked into assessing the quality of the strategy – a complex area that is independent of the Balanced Scorecard itself.

A first test of an effective strategic Balanced Scorecard is therefore the clarity and consistency of strategic goal articulation and how well the chosen strategic objectives and associated measures relate to these goals. Strategic clarity is dependent upon the designers of the Balanced Scorecard having a good understanding of the expected results of successful strategy implementation, and of the strategic activities needed to deliver these results. This understanding will come from a combination of a solid strategy definition process with good local knowledge of the organisational unit being managed - as a

result the best strategic Balanced Scorecards are those designed with direct support from the managers who will use them.

- *When evaluating the quality of a Balanced Scorecard of this type, the auditor will typically assess the strategic documentation (strategic plans, business plans, destination statements, strategic linkage models/strategy maps, etc.); how these documents are/were created, maintained and used; how they inter-link; and the degree to which they are understood and used by the local management team.*

Objectives and criteria: Scorecard measures and targets

A Balanced Scorecard audit also needs to assess the Balanced Scorecard's measures and targets. Good measures reflect the underlying strategic objective, and are relevant to the management team's roles and responsibilities. Good measures are also easy to collect in a cost effective manner, and regularly available.

An audit should also look to see that measures are clearly documented, defining unambiguously the measurement formula, data sources, collection methods, frequency of collection, etc. Good measures documentation will also contain clear targets, plus the criteria for evaluating performance against the target.

The auditor should also assess whether the number of measures chosen is appropriate. Too large a number of measures will be time consuming and costly to administer, and can make it difficult for management to identify and focus on the issues most in need of their attention. Finally, the auditor should evaluate whether targets measure sensibly balance ambition and realism, possibly by examining historical success rates in achieving targets.

Objectives and criteria: evaluating Scorecard usage

Even the best-designed Balanced Scorecard is of little value if no one uses the performance information being produced. An audit therefore also needs to assess how effectively the Balanced Scorecard is used as a management tool in support of improved performance. This can involve evaluation of: the timing and sequencing of the review cycle; how information is presented in the Balanced Scorecard report; how data is reported; who attends review meetings; the agenda of the Scorecard review meetings; the action points coming out of these meetings, and; how these are followed up.

These last two points are central to the effectiveness of Balanced Scorecard: managers must use the information provided to take better decisions and actions – the drivers of better performance – than they would have made in the absence of the system. An audit must therefore examine behavioural aspects of usage: do managers believe the content is relevant, do they demonstrate accountability for the performance results being reported, and do they manage more effectively in light of Balanced Scorecard information?

Finally, an audit can also examine how the Balanced Scorecard usage is connected with other core management processes – for example, how the Balanced Scorecard influences the business planning, budgeting and personal performance management processes. If the answer is determined to be 'very little', then the auditor will likely conclude that the Balanced Scorecard is not delivering its potential benefits. This part of the audit therefore seeks to identify how the usability and usefulness of the Balanced Scorecard can be improved.

Final thoughts

Auditing a performance management system such as a Balanced Scorecard, is not easy to do well. Because there are no formerly established norms, a good auditor must possess significant experience in designing, implementing and using performance measurement and management systems. Hard, technical skills, such as an ability to evaluate complex measure definitions, need to be combined with softer behavioural skills, including the ability to identify sources of resistance across members of a management team.

The audit objectives and criteria supplied in this FAQ answer are intended to illustrate the need for robust planning of a Balanced Scorecard audit – what are you going to assess, how and why? It is important that the auditor secure prior agreement from the client as to the audit's scope, criteria and methodology – this will maximise the likelihood that the audit will promote improvements to the content and usage of the Balanced Scorecard.

More Information...

The Resources section of the 2GC web site contains other 2GC FAQs relating to the Balanced Scorecard, in particular the 3rd Generation Balanced Scorecard. The website also has recommendations for books and articles on the subject and links to useful web sites. For information on 2GC's services including our consultancy and training programmes, visit our services section of the web site or email: info@2GC.co.uk.

About 2GC Active Management...

2GC is a research-led consultancy expert in addressing the strategic and performance management issues faced by organisations in today's era of rapid change and intense competition. Central to much of 2GC's work is the application of 3rd Generation Balanced Scorecard, an approach to strategic implementation, strategy management and performance measurement.