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To: Paul Ebling

30 December 2009

PERFORMANCE REPORTING: A EUROPEAN DISCUSSION PAPER

Dear Paul,
we are pleased to respond to your request for comments on *Performance Reporting: A European Discussion Paper*, published by Proactive Accounting Activities in Europe (PAAinE) in March 2009.
Our comment letter will focus on Chapter 3, Question 2, of your Paper.
Please contact us if you would like to discuss any of the points raised in the attached response.

Yours sincerely

Luigi Borré[1]

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ANSWERS TO SPECIFIC QUESTIONS

Question 2: Do you agree with the observation in this chapter that, at the level at which standards are written, there is no generally agreed notion of what represents 'performance' and that in fact performance is a complex, multi-faceted issue that cannot be encompassed in one or a few numbers? If you do not, please explain your reasoning.

We agree that – in the light of current accounting standards – there is no generally agreed notion of what represents 'performance', since performance itself is a complex and multi-faceted issue.
That said, we like to draw your attention to some points in Chapter 3.

a) In points 3.9, 3.10 and 3.11, you distinguish between 'overall performance' – a wider notion of performance which comprises growth in market share, consumer satisfaction, environmental responsibility and so on – and 'financial performance' (i.e., performance which is captured through recognised items of income and expense).
You suggest that 'all these aspects of (overall) performance will eventually feed through into financial performance'.

We believe that, generally speaking, overall performance comprises all the benefits that the owner of an entity expects to gain from the entity itself.
These benefits and positive results could be:
(1) strictly financial and economic results, *i.e.* positive results and cash flows which flow to the owner, directly *via* the entity, in a fair and foreseeable length of time;
(2) "broader" financial and economic results, *i.e.* positive results and cash flows which flow to the owner: a) not directly *via* the entity (for instance, indirect advantages directly to the entity's shareholders), or b) at a date later than the time when the effective pre-conditions for the results were created;
(3) non-financial or non-economic results, as social objectives (recognition, prestige, social support, the cultural promotion of the social system the entity operates in, and so on), environmental goals (for instance, reduction of environmental impact, improvement of the ecosystem) or, in general, competitiveness (ability to influence the markets, strengths with respect to customers, suppliers, competitors).
The results under (1) represent 'financial performance', while results under (2) and (3) represent the share of 'overall performance' not inducted by financial performance – a 'meta-financial' performance.
In that sense, we believe that 'meta-financial' performance may be certainly translated into a financial-type performance, as in point (2).
Yet, in some cases, 'meta-financial' performance does not produce financial flows at any level and at any time – as in point (3), so that we suggest that not all the aspects of (overall) performance will eventually feed through into financial performance.

Moreover, we believe that it is also important to look at the financial performance of an entity from a broader perspective than the single economics of the entity itself (see the following point c).
In effect, positive streams of cash flows can be captured directly by the shareholders of an entity, due to the operations of the entity itself.

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Consider, for instance, entities which operate in specific industries – like, for example, professional sports – which systematically show a poor and feeble financial performance, but which can have a positive financial impact for their shareholders all the same, *via* prestige, recognition and, in short, the visibility which follows the ownership of famous professional sports' teams.
The importance of 'meta-financial' performance becomes manifest also in other, significant industries, for instance press and media companies; and, in the end, the quality and the amount of banks' raising – which is extensively used as a key-element when assessing their values – is, all in all, just one of the aspects of 'meta-financial' performance of these companies.

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b) In point 3.12 you cite the fact that, at the current development of IAS/IFRS standards (including also discussion papers), there is not a definition of what performance means in the context of reporting income and expenses.

If it is certainly true for accounting standards (which are mainly devoted to explain "what to report" in order to assess the entity's performance, rather than to strictly define "what performance" really is), accounting literature deals from its roots with performance, and it offers some interesting definitions.
For instance, some Italian Masters of accounting literature (for instance: Gino Zappa, 1957) define 'economic performance' as the ability of an entity to continue its operations – during time – with the respect of some key financial balances, and without a systematic contribution by its shareholders.
Such a narrow definition – if accepted – is close to the notion of 'financial performance'.
In that sense, we suggest that a future definition of performance be the resulting point of different approaches: in particular, accounting standards and accounting literature.

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c) In point 3.19 you present 'other key performance indicators' – relating to business activity, such as production levels, market share, and so on – and you say that they are not discussed in your Paper, as they do not derive from GAAP financial statements.
Yet, in point 3.38 you admit that 'for investors and analysts the ultimate goal of performance measures in not performance per se, but value', and that performance metrics are just 'raw materials' when valuation models have to be prepared.

The 'other key performance indicators' of your Paper represent, in our view, the indicators of the 'meta-financial' performance discussed above.
That fact that the 'other key performance indicators' are – at the same time – useful for investors and analysts since they offer valuable insights into overall performance, but not clearly and easily presented in the financials since they do not derive from GAAP measures, has to be carefully considered.
In effect, we believe that a comprehensive study of performance can not be detached from the following two issues.
1) What is the definition of 'entity'?
2) Who are the 'real users' of financial statements?

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Under point 1), accounting community (practitioners, academics, institutions) should investigate in deep what an 'entity' is, before defining the rules for the presentation of its assets, liabilities, income and expenses: for instance, can we define as 'entities' companies with systematically poor or negative results, as mentioned before in the case of professional sports?
Under point 2, it has to be considered that a single set of financial and non financial information is eventually too limited for users who are consistently different: shareholders do not require the same information as analysts, clients' information needs are different from employees', and so on.
In other words: the notions of 'performance', 'entity' and 'real users' of financial statements have to be jointly examined.