

Enhanced Business Reporting

A formal joint proposal to the AICPA from Accenture LLP & AssetEconomics, Inc.
October, 2004



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Executive Summary

While intangible assets have taken on an increasingly pronounced role in key value drivers in the economy, standard accounting practices have remained fixated on tracking, measuring and managing tangible assets. Consequently, a large majority of the enterprise assets that create value go under-recognized and under-reported. As companies cannot manage what is not being measured, a large proportion of the assets that are responsible for creating value in today's economy are by default inadequately managed¹.

In traditional financial reporting, value is defined more in terms of Book Value and is historical in nature. Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A), and supplementary disclosures for traditional financial reporting are generally based on historical performance and variances in statutory financial position according to the application of GAAP. Forward Looking Statements (FLS) provide the opportunity to include objectives, plans and projections for future operations, as well as statements about probable and possible future economic performance. As AICPA's Enhanced Business Reporting (EBR) Committee has noted, the marketplace – both investors and company management teams – need a more forward-looking tracking and reporting approach. In addition, the key question that remains stems from what exactly is being reported, particularly in the FLS, and how useful that information is in helping shareholders and other stakeholders clearly understand the direction in which the company is headed, what their final destination is and how long will it take them to get there ².

Our EBR proposal is based on forward-looking economic principles, namely that a company's stock price is based on the market's expectations about future earnings and incorporates the forward-looking perspectives of management and key stakeholders on factors impacting shareholder value.

As new accounting practices derive from new accounting concepts and principles, our specific EBR recommendations are based on a comprehensive framework, using widely known principles such as Total Return to Shareholder (TRS), Total Economic Profit (TEP), and concepts of Current Value and Future Value.

We make two sets of recommendations for EBR.

First, we propose that companies adopt a **TRS Mapping Framework** to explain the underlying constructs of shareholder value for their company. We recommend four statutory additions to financial reporting and six supplementary financial reporting items. These will provide a clear method for understanding shareholder value accretion period-on-period as well as the expectations for future growth in TRS embedded in the share price.

Second, we propose that companies adopt an **Operational Reporting Framework** to provide comprehensive, consistent, coherent and comparable information on the key valued attributes

and their value drivers – the resources and activities that have and are expected to drive value accretion period-on-period as well as sustainable increases in expectations for future growth.

Given its conceptual foundation and its direct linkages to current accounting, we think that both the EBR frameworks we propose are within the managerial reach of most listed companies. In order to demonstrate the applicability of these EBR practices, we have included descriptions of a number of proprietary Accenture and AssetEconomics methodologies and decision-support tools in our proposal.

Considerable debate has yet to occur before any stakeholder consensus will be reached on classification of intangible assets, and methods for reporting them. We argue that our EBR framework is flexible enough to accommodate these differences. As long as methodologies and data sources are adequately disclosed, all users of our EBR frameworks will have a much richer insight into the future of the enterprises they are evaluating and accordingly, will be able to value these enterprises on a much more robust basis.

Purpose

The AICPA's Special Committee for Enhanced Business Reporting ("SCEBR") is laying the foundations for the establishment of a market-led consortium, the Enhanced Business Reporting Consortium that will be taking the lead in developing a voluntary, internationally accepted framework for business reporting. This document represents the formal submission of a joint proposal to the AICPA from Accenture and AssetEconomics Inc., summarizing our points of view on EBR. It serves to further amplify our prior presentations and oral explanations (attached).

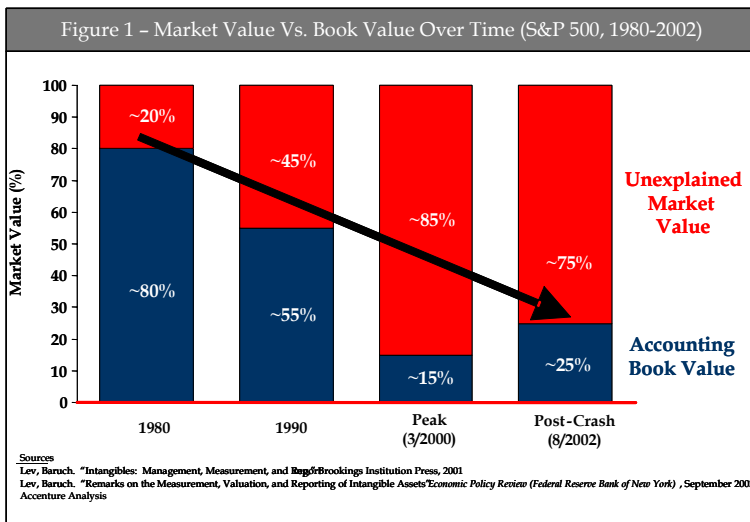
Our proposal specifically addresses the Committee's EBR objective of clarifying the linkage, relevance and relationship of traditional accounting methods to shareholder value. Our proposed solution supplies a comprehensive, scalable and authoritative methodology which is consistent with the SEC's general commitment to improved, investor-centric reporting. Our solution is also consistent with the Committee's specific commitment to a collaborative EBR effort that is relevant to the needs of its multiple stakeholders – including regulatory agencies, the investment community, the accounting profession, technology and software enablers, academia, industry associations, and public and private companies.

This document summarizes our two-part conceptual framework for EBR, based on extensive research on the topics of intellectual capital, and Enterprise Value and Future Value. We propose a TRS Mapping Framework comprised of **four new statutory reporting statement items to supplement traditional reporting instruments**. In addition, we propose six **incremental additions to traditional financial reporting practices**, to support EBR. We also propose an **Operational Reporting Framework comprised of four templates that will provide information on the firm's key attributes, firm's key value creating processes, the firm's key value driver resources and processes and the firm's key performance measures**.

The TSR Mapping Framework and Operational Reporting Framework constitute our EBR action items for formal Committee consideration.

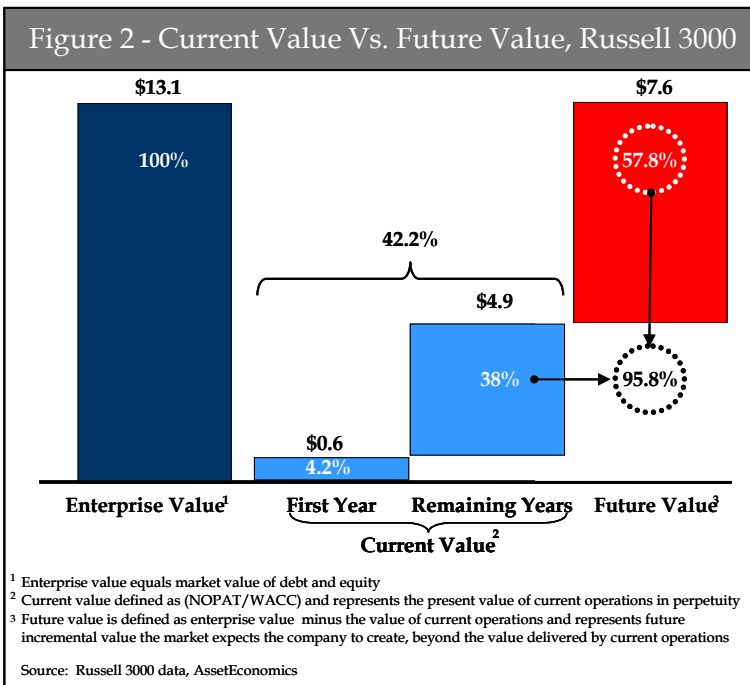
Introduction

Traditional financial statements do not adequately record, track and measure those resources (balance sheet) and activities (income statement) that drive a significant portion of value for today's companies. As a result, managing financial performance - or making investment decisions -- using traditional accounting earnings-based measures is an increasingly difficult proposition. The same is true when attempting to identify, explain and communicate the total enterprise value of a company.



During the past three decades, the migration of value from asset categories covered by GAAP to newer and unreported asset categories has proceeded steadily. As just one indicator, accounting book value of the S&P 500 has declined from ~80% of total enterprise value in 1980 to ~25% in 2002 (see Figure 1). As this chart indicates, the decoupling of total market value into accounting assets and unexplained market value is a long-term secular trend that transcends business cycles.

Current and Future Value



Referring to Figure 2, approximately 42% of aggregate US stock market value is represented by traditionally defined Current Value - operating-year earnings, capitalized by a weighted average cost of capital, assuming that firms will generate those earnings into perpetuity. The remaining 57.8% of the total value of the US stock market is unexplained market value. The unexplained portion is based on investor expectations of future growth and includes things like intangibles, intellectual capital, market sentiment and other extrinsic factors for which the company has no direct control (see Figure 2).

Broken down in more detail, our extensive analysis of the US equity markets (using the Russell 3000) demonstrates that annual earnings (income statement) on average account for 4.2% (see Figure 2, Current Value, first year earnings) of equity values and that the converse, 95.8%, represents both the current year's earnings capitalized into perpetuity (\$4.9 trillion) and \$7.6 trillion of unexplained market value. Put more bluntly, of \$13 trillion of aggregate equity value, today's P&L accounts for only \$0.6 trillion.! This assumes – a major leap of faith – that current

Figure 3 - Future Value by Industry, May 2003

Sector	No. Cos.	Current Value \$ m.	Future Growth \$ m.	FG as % EV	Enterprise Value \$ m.
Energy	113	346,888	394,896	53%	741,784
Materials	134	263,747	298,577	53%	562,325
Capital Goods	187	518,050	416,639	45%	934,690
Commercial Services & Supplies	145	164,674	186,930	53%	351,604
Transportation	52	102,405	287,745	74%	390,150
Automobiles & Components	40	88,607	192,749	69%	281,355
Consumer Durables & Apparel	122	186,960	36,215	16%	223,176
Hotels Restaurants & Leisure	79	146,795	66,140	31%	212,935
Media	97	(47,143)	776,438	106%	729,295
Retailing	166	479,462	381,682	44%	861,144
Food & Drug Retailing	28	145,014	46,173	24%	191,187
Food Beverage & Tobacco	70	573,139	172,745	23%	745,884
Household & Personal Prods	22	142,871	144,054	50%	286,925
Health Care Equipment & Services	212	317,986	281,780	47%	599,766
Pharmaceuticals & Biotech	169	407,249	667,742	62%	1,074,991
Banks	288	630,742	124,255	16%	754,997
Diversified Financials	64	478,710	167,958	26%	646,668
Insurance	92	296,581	98,891	25%	395,472
Software & Services	206	(374)	519,025	100%	518,651
Technology Hardware & Equipment	311	(273,259)	1,285,411	127%	1,012,152
Telecommunication Services	49	89,295	610,300	87%	699,595
Utilities	99	274,684	481,348	64%	756,032
Totals	2,745	5,333,082	7,637,693	59%	12,970,775

Source: Russell 3000 data, AssetEconomics

earnings can be maintained forever with no improvement or decline. Here, current year capitalized earnings and capital employed explain 42.2% of equity value, or Current Value, leaving a staggering \$7.6 trillion as growth premiums currently priced into the share markets. This “Future Value” is distributed unevenly through the economy, but largely created and concentrated in industries and companies built on intangible assets (see Figure 3).

Like many others who have debated this issue, we believe that intangibles such as prevailing brands, skilled human capital and proprietary networks represent a goodly portion of Future Value, though certainly not 100%.

Given that a substantial portion of Enterprise Value is comprised of Future Value, albeit not for all industries, and that Future Value has intangible assets as a large component, it stands to reason then the potential market impact of Future Value is dramatic³. If the current accounting framework was equal to the task of tracking, analyzing and managing this Future Value component in its entirety, senior executives could feel at ease.

But the accounting framework is not equal to the task, as business and academic literature has noted since the late 1970s. The more structured approaches to address this shortfall of traditional financial accounting practices like EVA™ (Economic Value Added™), MVA™ (Market Value Added™) and the Balanced Scorecard™ are but a sampling of the many attempts to more closely align shareholder value to accounting-based returns.

The case for EBR might thus be framed as one of a currently disproportionate attention on 4.2% of value drivers (income statement) (see Figure 2, first year of Current Value), and the clear need for more insight into the other, staggering 95.8% (Figure 2, Current Value remaining years + Future Value). Accounting frameworks and technology solutions that seek to further dissect or manipulate existing income statements, balance sheets and cash flow statements to squeeze out more information from the current 4.2% would seem to be missing the point of EBR. In

contrast, Accenture and AssetEconomics would squarely have company managers begin to focus upon and address what is driving 95.8% of their equity value.

Shortcomings of Current Solutions to Address the Problem

One major shortcoming of current accounting systems for firm managements and firm analysts is their historic perspective. Accounting systems were developed and widely implemented when the value-driving asset base was primarily tangible – buildings and equipment, or physical processes for the manipulation, combining and crafting of raw materials into some finished product. Over time, accounting systems have become more robust in their ability to capture additional dimensions of financial transactions, such as time, currency, product, department, geography, etc. However refined, this information is still primarily backward-looking, and provides greater insight into where resources have been used and to what efficiency level they have been utilized and less insight into potential future performance.

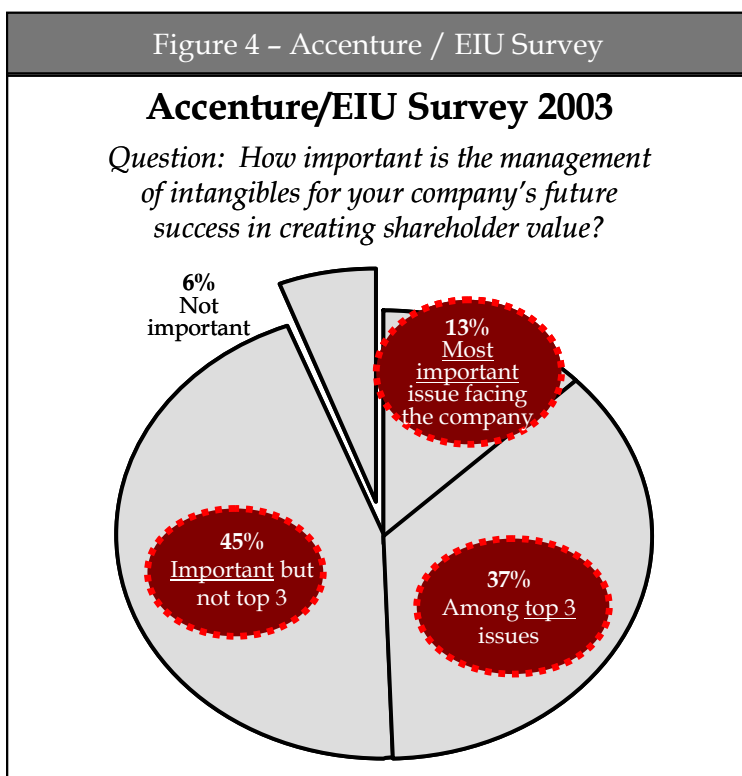
And while intangible assets have taken on a much larger role in key value drivers in the economy, standard accounting practices have remained fixated on tracking, measuring and managing tangible assets. Consequently, a large portion of enterprise assets go under-recognized and underreported. Moreover, as companies cannot manage that which is not being measured, a large proportion of the assets that are responsible for creating value in today’s economy are being inadequately managed.

So company senior executives continue making key decisions based on fiscal-year, accounting-based financial information to drive their organizations. They use these data on current

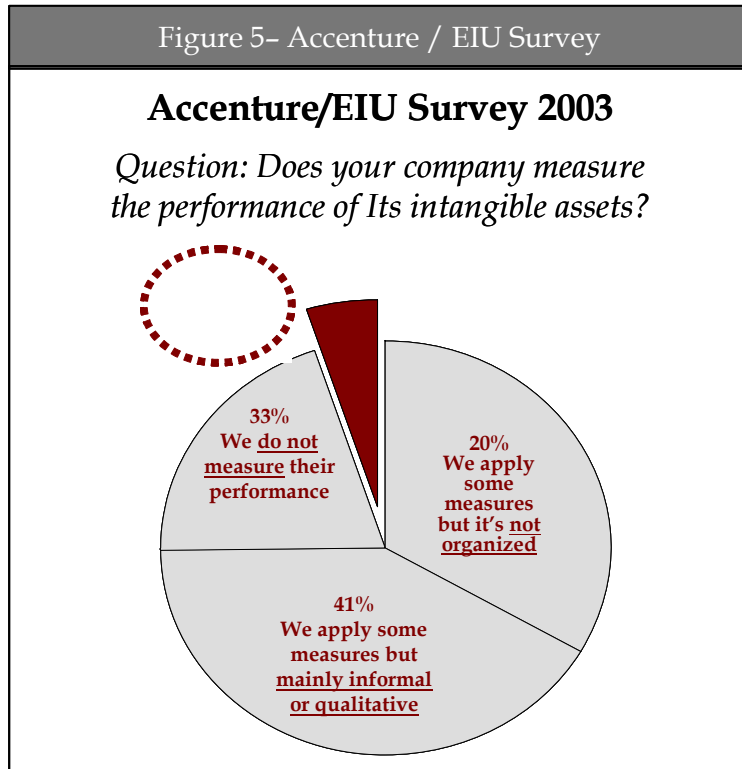
operating results to develop strategies that, for lack of sufficient forward-oriented data, may sub-optimize future growth. And they continue to use basic clear-cut accounting practices to align (or attempt to align) their management decisions to stock market impacts, in markets that have become structurally more volatile.

Widespread Awareness of Intangible Value Drivers

In a study conducted by Accenture and the Economic Intelligence Unit (EIU) of some 120 senior business executives representing over 50 industries in 27 countries, 94% of executives reported the management of intangibles was an important issue for their companies’ future success in creating shareholder



value. (See Figure 4). At the same time, only 5% of those executives claimed they had a robust system in place to measure the performance of their intangibles and intellectual capital. (See Figure 5).

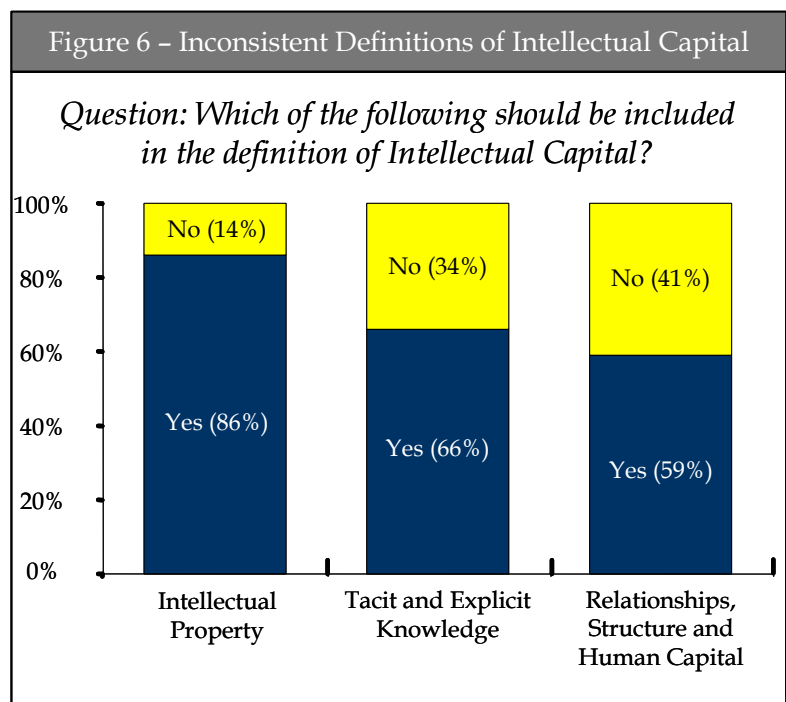


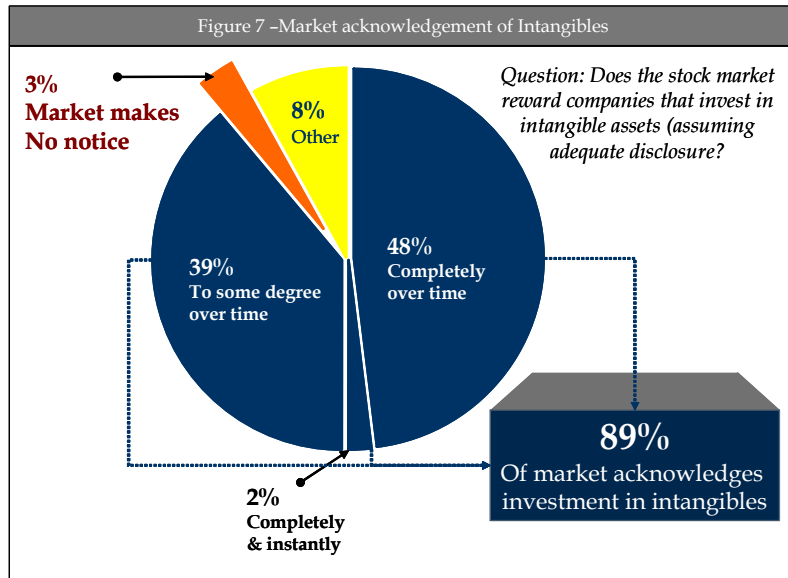
One explanation for the huge discrepancy between perceived need and perceived solution is a lack of consensus on definitions of intangible assets and intellectual capital (see Figure 6).

Nearly half of the same executives from the Accenture/EIU survey defined intangibles as “R&D, brand, intellectual property and goodwill only as defined by relevant accounting standards boards.” Greater than a third said intangible assets represent “all assets that cannot be valued with any certainty, but which are placed on the balance sheets.” The remaining portion of executive respondents in the survey (16%) either did not have a clear understanding of intangibles, had a slightly different interpretation of supplied definitions, or

defined it as something unique altogether. ⁴

So what does the marketplace have to say about companies that invest in, track and manage intangibles? From our Accenture/EIU survey, 89% of the executives affirmed that the stock market compensates organizations that did in fact invest in intangibles. (See Figure 7) Nearly half (48%) of the respondents proclaimed the market fully rewards investments in intangibles over time, 39% stated to some degree over time and 2% stated the market completely and instantly rewards companies for their investments in intangibles. Only 3% of respondents communicated that the market takes no notice of a company's





investment in intangibles while 5% simply did not know. The overriding conclusion then is that senior executives believe the stock market does recognize and reward companies for investments in intangibles; however, this occurs to varying degrees and over different time horizons.

Again, our Accenture/EIU survey confirms that the issue is a market priority. More than half of executives questioned said the integrated, comprehensive management of

intangible assets was either the most important issue (13%) or one of the top three issues (37%) facing their company (see Figure 4).

Five Asset Types

As senior executives plan and strategize for the near and long term, they clearly need to consider all forms of resources – tangible and intangible, traditional and intellectual. This is especially critical in order to manage enterprise Future Value effectively. When planning investments, executives need to clearly understand the linkage between the particular investment, the asset class targeted for investment, and shareholder value creation, calculating for the many diverse characteristics of distinct asset types.

Precisely defining asset types is critical for several reasons. First, it clarifies the limitations of traditional accounting, which today only acknowledges the tangibility of monetary and physical assets. Second, it highlights the large swaths of untracked and unreported assets that are in fact driving shareholder values in numerous industries. Third, it sets the conceptual stage for an EBR framework that can encompass these hidden drivers. As FASB noted in its “Business & Financial Reporting, Challenges From the New Economy” report of April, 2001, “The conceptual frameworks of financial reporting pave the way for vital and resilient reporting systems.” In that spirit, asset classification that includes intangibles is an essential pre-condition of EBR.

Figure 8 is an Asset Classification Framework developed by AssetEconomics that comprehensively displays all asset types categorized into their classical recognition principles – whether **tangible** or **intangible**. Asset types are further broken down into **traditional accounting assets** and **intellectual capital assets**. While the traditional accounting assets include the standard tangible aspects of **monetary** and **physical** assets such as ‘cash’, ‘property’, ‘plant’ and ‘equipment’, monetary and physical assets also have intangible features such as ‘credit ratings’, ‘balance sheet strength’ and ‘plant location’ ⁵.

Figure 8 – Asset classification framework

		ASSET TYPE				
		Traditional Accounting Assets		Intellectual Capital Assets		
		Monetary	Physical	Relational	Organizational	Human
ASSET RECOGNITION	Tangible	<ul style="list-style-type: none"> Cash Investments Receivables Payables Compensation and benefits incl. long term incentive schemes (incl. option schemes) 	<ul style="list-style-type: none"> Property, Plant & equipment Inventories (raw Materials, WIP, finished goods) Stranded Assets Physical Work Environment 		<ul style="list-style-type: none"> Documented systems Documented processes Access rights Patents Brands Mastheads Management contracts Employee contracts Employee development & training programs Performance management systems Customer lists Customer contracts Supplier contracts Formal alliances 	
	Intangible	<ul style="list-style-type: none"> Credit Ratings Accruals Balance sheet strength Cash flow volatility 	<ul style="list-style-type: none"> Plant location 	<ul style="list-style-type: none"> Stakeholder support Preferred status Organizational reputation Rights to tender, to design, to participate Networks Regulatory imposts 	<ul style="list-style-type: none"> Organizational structure Culture 	<ul style="list-style-type: none"> Leadership Problem solving ability Work environment (interaction) Recruitment and selection Career paths Rewards and recognition Capabilities Employee satisfaction Employee retention Employee relations Knowledge (incl. tacit) Functional skills Experience

Source: AssetEconomics

Tracked by traditional accounting systems
 Not tracked by traditional accounting systems

The same matrix holds true for intellectual capital assets. The framework breaks down this broad asset type into three further classes of **relational**, **organizational** and **human** assets, each of which has distinct ownership, behavioral and control qualities. Each of these asset types, like their tangible counterparts, potentially has tangible and intangible recognition aspects. A ‘customer contract’, for example, would represent a tangible, organizational asset whereas the ‘firm’s reputation’ would represent an intangible relational asset. Likewise, ‘leadership’ is an intangible, human asset. Relational and human intellectual capital assets are almost exclusively intangible, while organizational intellectual capital assets are almost always tangible. The reason we find these categorizations for intellectual capital assets is that the act of transforming an intangible relational or human asset into a tangible form (through giving it a physical form) also causes it then to become organizational (owned by the company). Computer software codes, for example, represent codified knowledge and would previously have represented human ‘tacit knowledge’.

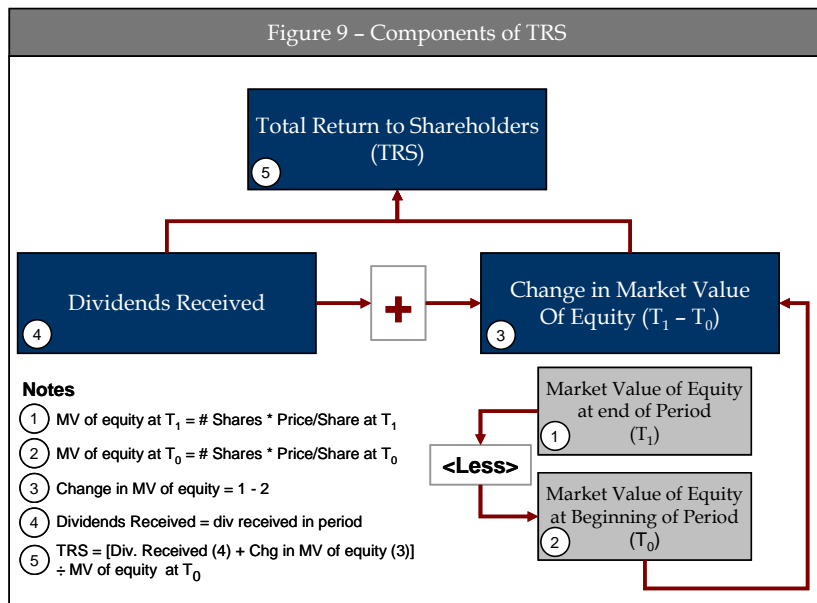
In general, only the **tangible** aspects of **monetary** and **physical** asset types are currently tracked by accounting systems and reported on the balance sheet; their intangible aspects do not get tracked or reported. As for either the tangible or intangible aspects of intellectual capital assets, while many have not been quantified, the traditional income statement represents the standard location for the reporting of these types of resources given that they are operating expenditures and treated as expenses matched with the revenues they helped generate for a given period. The key question here then would be where should such expenditures reside for tracking, measuring and reporting?

A final note is that this resource-based view does not represent a functional view. Figure 8 illustrates that, for example, managing the human resources function will require decision-making of resources that have human, organizational and physical form and are both tangible and intangible.

The TRS Mapping Framework and EBR

Throughout this document we have discussed Future Value and the sizeable role it plays in comprising a firm’s enterprise value. We have discussed the fact that today’s systems fall short of providing managers the types of information and analytical capabilities they need to effectively understand Future Value, let alone proactively manage it to drive shareholder value creation. We have also discussed the intangible form of assets dissected into three resources -- relational, organizational and human -- and the fact that their differing characteristics necessitate separate measurement and accounting treatment.

The key question still remains unanswered, even with the decomposition of Future Value into



intangible assets and the greater, more formalized presence of entirely new business models now play in today’s economy – *How do I as a manager of the enterprise explain changes in shareholder value given the shortcomings of the standard set of tools I have to work with today?*

Conceptually, our answers come from our TRS Mapping Framework and its embedded metrics.

As we define it in Figure 9, TRS is comprised of dividends received plus the change in Market Value of

the equity. Put differently, dividing the sum of dividends received and the delta in Market Value of equity from time period 0 to time period 1 by the original share price produces TRS. Total Returns to Shareholders offers the immediate advantage of providing comparable data on

listed companies, and widely accepted definitions of results. In addition, in our experience, TRS is strongly correlated to other key indicators of operating performance.

Methodologically, our answer lies in an approach that focuses on all aspects of value, both current and future, and on all asset drivers – tangible and intangible - in a holistic manner.

Accenture has developed a TRS methodology called “TRS Mapping,” that tightly aligns internal financial performance measures with TRS. This methodology aims to accomplish two goals:

- 1. Clarify and detail out 100% of an enterprise’s valuation by connecting TRS back to traditional financial statements - Income Statement & Balance Sheet**
- 2. Simplify the communication and translation of enterprise performance to both internal and external stakeholders**

Simply stated, TRS Mapping has the objective of linking connections among differing TRS drivers. Traditional accounting calculations [(dividends + change in MV of equity)/earnings], for example, will not yield TRS. This calculation may provide an earnings multiple that approximates EPS; however, it will only motivate an enterprise to generically increase earnings. Depending on how this action is implemented (reducing investment or cutting cost), the multiple may actually be lowered and hence, firm value would be reduced.

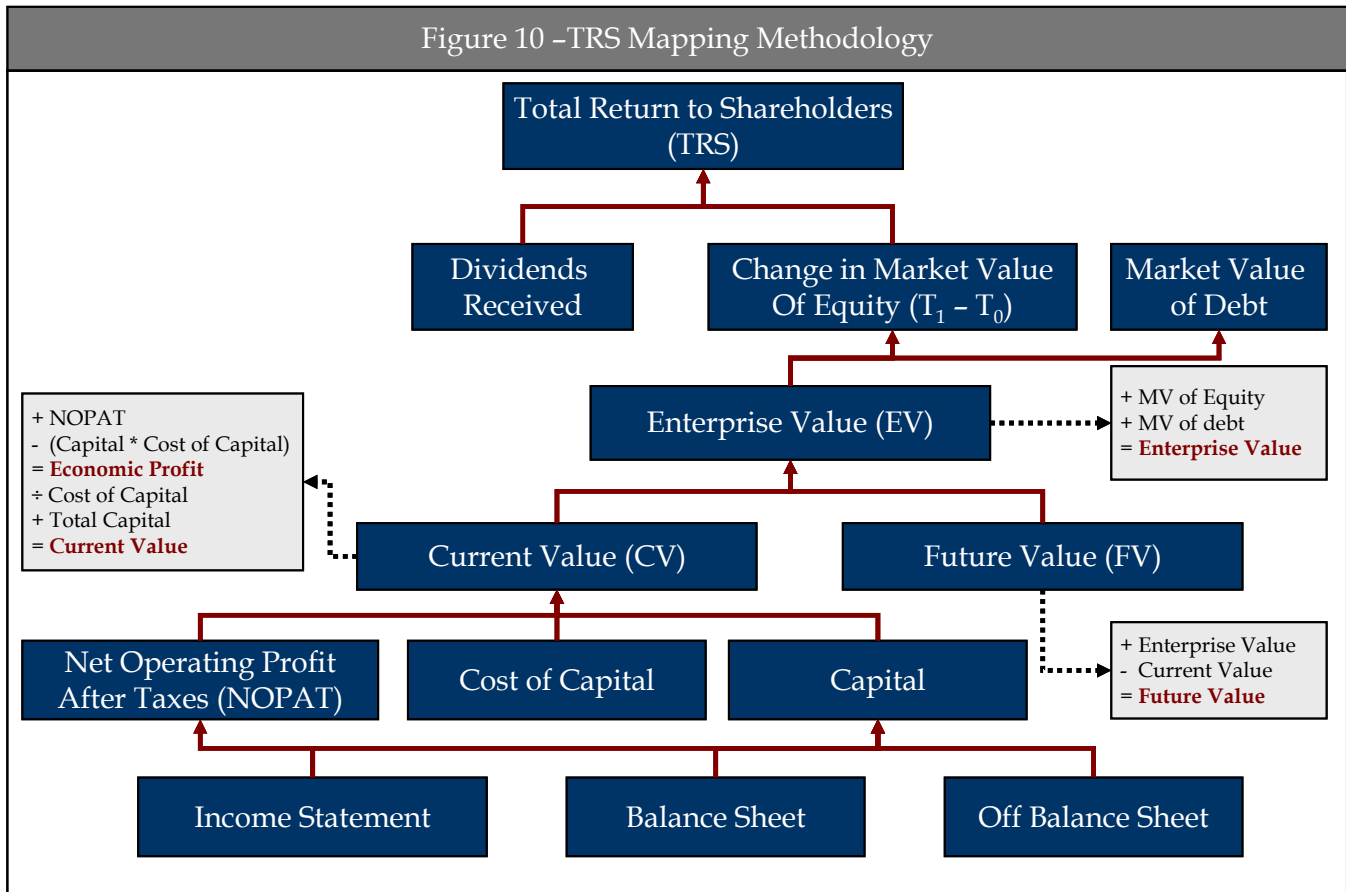
These inadequacies are particularly true when dealing with intangible assets, which are largely formed by SG&A expenses – training & education, software development, research, salaries, etc. With intangibles, no clear tradeoff exists between EPS and value creation. As budgeted amounts for SG&A expense increase, EPS decreases (without a commensurate increase in sales) given that SG&A expense adversely affects NOPAT (Net Operating Profit After Taxes).

“Economic Profit” calculations that factor in a cost for using the capital upon which earnings were generated helps bring us a step closer to economic results versus standard accounting principles when explaining earnings. “Total Economic Profit” offers managers the ability to annualize, report and manage the tradeoff between Current and Future Value with the key component being the de-capitalization of Future Value. Using this concept, TRS Mapping and EBR statements then provide a commonsense path of sound information starting from traditional accounting statements and moving up to total enterprise value and finally to TRS.

In Figure 10 (next page), we see that from a standard Income Statement, we get Net Operating Profit After Taxes, or NOPAT (with some adjustments), which then has a capital charge removed from it. The capital charge represents the cost of using the capital for which earnings were generated. The capital charge is total capital multiplied by the firm’s Weighted Average Cost of Capital (WACC). The end result of NOPAT less the capital charge yields a standard Economic Profit amount.

Taking the Economic Profit amount just calculated and dividing that by the cost of capital and adding back to this result total capital, we now have an approximation of the market’s valuation

of current operations into perpetuity. Stated alternatively, we call this ‘Current Value.’



As is the case with any EBR concept, implementation tools are necessary. To facilitate these calculations, a “Total Economic Profit” measurement concept can be used to measure, manage and promote company performance by linking it directly back to shareholder return. The TRS Mapping Framework also clarifies a few other EBR principles. Total Enterprise Value, for example, is calculated by adding the market value of equity (# shares outstanding x share price) to the market value of debt

EBR Recommendations

Since the objective of EBR is to provide investors with more relevant information on the key changes and drivers of the company’s value, let us first summarize differences between EBR and traditional financial reporting.

The foundation of traditional financial reporting in the US is accrual-based accounting according to Generally Accepted Accounting Principles (GAAP). GAAP, as defined by the Financial Accounting Standard Board (FASB), is essentially a “rules-based” framework that ultimately defines the statutory income reporting requirements in terms of Net Income and Earnings per Share (EPS). In traditional financial reporting, value is defined more in terms of “book value” and is historical in nature. Further, Management’s Discussion and Analysis of

Financial Condition and Results of Operations (MD&A), and supplementary disclosures for traditional financial reporting are based on historical performance and variances in the statutory financial position according to the application of GAAP. As previously noted, the Forward Looking Statements (FLS) provide the opportunity to include objectives, plans and projections for future operations, as well as statements about probable and possible future economic performance. However, very few do. Most of these are also generally based on historical performance.

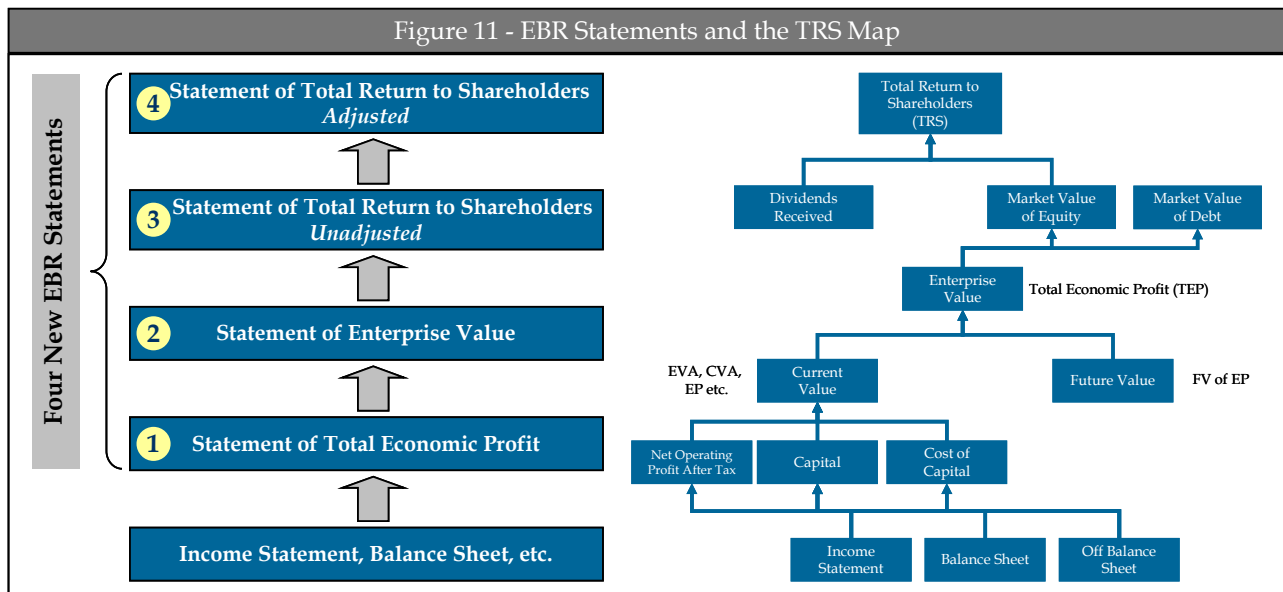
To report TRS, Total Economic Profit (TEP) and the key drivers of Current and Future Value, our EBR proposal rests on the forward-looking realities of most company stock prices, which are now based on the market’s future expectations (including discounted cash flows, dividend distributions, price appreciation, etc.). Therefore, our EBR proposal incorporates the future perspectives of management and key stakeholders -- on financial and non-financial metrics, and on related causal factors impacting shareholder value. Our proposed FLS, MD&A and supplementary disclosures will include the relevant metrics that management uses internally to manage both Current and Future Value of a business.

Part I: TRS Mapping Framework Proposal for EBR Statements⁶

We propose a suite of four new EBR statements that are directly complementary to the traditional reporting instruments (Income Statement, Balance Sheet, Statement of Cash Flows and Statement of Stockholder’s Equity). These EBR statements are as follows:

1. **Statement of Total Economic Profit (TEP)**
2. **Statement of Enterprise Value**
3. **Statement of Total Return to Shareholders (TRS) - Adjusted**
4. **Statement of Total Return to Shareholders (TRS) - Unadjusted**

Our proposed EBR statements are founded on the TRS Mapping Methodology (Figure 11).



Incremental Requirements to Prepare EBR Statements

In order to generate the four new statutory reporting items, we also propose six incremental requirements to traditional financial reporting that includes, but are not limited to, the following:

1. Calculations and adjustments to arrive at Net Operating Profit After Tax (NOPAT)
2. Calculation of Weighted Average Cost of Capital (WACC)
3. Calculation of Return on Invested Capital (ROIC)
4. The calculation of Invested Capital, which may have significant adjustments that include but are not limited to operating leases, goodwill and potentially stock options
5. Adjustments for off balance sheet financing have to be incorporated into the Market Value of Debt
6. Disclosure of market capitalization data, specifically methodologies and sources of Beta

Statutory EBR Specifications

1. Statement of Total Economic Profit (TEP)

The purpose of this initial statement is to directly link EBR with traditional financial reporting information. Therefore, Earnings before Interest and Taxes (EBIT) is the key starting point. The additional disclosure included in this example (Figure 12) is to provide an alternative perspective on how Economic Profit of Current Value (EPCV) is determined by applying the spread between Return on Invested Capital (ROIC) and Weighted Average Cost of Capital

Figure 12 -Statement of Total Economic Profit						
XYZ Corporation Statement of Total Economic Profit \$ Millions						
	Prior Year	Change	Change %	Current Year	Change	Change %
Earnings before interest and taxes (EBIT)	\$ 1,358.9	\$ (2.8)	-0.2%	\$ 1,697.9	\$ 338.0	24.9%
Less: Cash Taxes	(530.0)	6.3	-1.2%	(656.7)	(126.7)	23.9%
Net Operating Profit After Tax (NOPAT)	829.0	3.6	0.4%	1,041.2	212.3	25.6%
Invested Capital	7,721.5	(326.4)	-4.1%	9,857.9	2,136.4	27.7%
Weighted Average Cost of Capital (WACC)	9.5%	-0.1%		9.0%	-0.5%	
Capital Charge	733.5	(39.1)	-5.1%	887.2	153.7	20.9%
Economic Profit of Current Value (EPCV)	95.4	42.6	80.8%	154.0	58.6	61.4%
Economic Profit of Future Value (EPFV)	675.4	(554.8)	-45.1%	1,282.0	606.7	89.8%
Total Economic Profit (TEP)	\$ 770.8	\$ (512.1)	-39.9%	\$ 1,436.0	\$ 665.2	86.3%
Additional Disclosure						
Return on Invested Capital (ROIC)	10.7%	0.4%		10.6%	-0.1%	
Weighted Average Cost of Capital (WACC)	9.5%	-0.1%		9.0%	-0.5%	
Spread (ROIC - WACC)	1.2%	0.5%		1.6%	0.4%	
Invested Capital	\$ 7,721.5	(326.42)	-4.1%	\$ 9,857.9	2,136.4	27.7%
Economic Profit of Current Value (EPCV)	\$ 95.4	42.6	80.8%	\$ 154	58.6	61.4%

(WACC) to Invested Capital. Please note that EPCV is the same in concept to residual income or Economic Profit.

Additionally, there can be disclosures to further support the calculation of Cash Taxes (since adjusted for interest income, interest expense, operating leases, retirement liabilities and other items), Invested Capital, WACC and ROIC.

2. Statement of Enterprise Value

Once Total Economic Profit is reported, we can then move ahead the TRS Map to Enterprise Value to reconcile the market's valuation of current operations and growth (Figure 13).

Figure 13 -Statement of Enterprise Value						
XYZ Corporation Statement of Enterprise Value \$ Millions						
	Prior Year	Change	Change %	Current Year	Change	Change %
Closing Share Price of Equity	\$ 29.07	\$ (15.86)	-35.3%	\$ 53.25	\$ 24.18	83.2%
Number of Shares Outstanding (in Thousands)	322.0	2.74	0.9%	324.7	2.68	0.8%
Market Value of Equity	\$ 9,359.7	\$ (4,983.3)	-34.7%	\$ 17,287.6	\$ 7,927.9	84.7%
Market Value of Debt	6,486.5	(503.4)	-7.2%	8,544.9	2,058.4	31.7%
Enterprise Value	\$ 15,846.2	\$ (5,486.7)	-25.7%	\$ 25,832.5	\$ 9,986.3	63.0%
Additional Disclosure						
Economic Profit of Current Value (EPCV)	\$ 95.4	\$ 42.6	80.8%	\$ 154.0	\$ 58.6	61.4%
Weighted Average Cost of Capital (WACC)	9.5%	-0.1%	0.0%	9.0%	-0.5%	0.0%
Value of EPCV in perpetuity	1,004.3	454.6	82.7%	1,711.0	706.7	70.4%
Plus: Invested Capital	7,721.5	(326.4)	-4.1%	9,857.9	2,136.4	27.7%
Current Value	8,725.8	128.2	1.5%	11,568.9	2,843.1	32.6%
Enterprise Value	15,846.2	(5,486.7)	-25.7%	25,832.5	9,986.3	63.0%
Less: Current Value	8,725.8	128.2	1.5%	11,568.9	2,843.1	32.6%
Future Value	7,120.4	(5,614.9)	-44.1%	14,263.6	7,143.2	100.3%
Debt to Equity Ratio	0.69	0.20	40.8%	0.49	(0.20)	-29.0%

In the example above, the market value of equity is simply computed by multiplying the closing stock price by the number of shares outstanding at the end of the stated reporting period. This information links the Statement of Stockholder Equity to the capital markets and is a compliment to the SEC disclosure for "Market Registrant's Common Equity and Related Stockholder Matters" where only the high and low stock price in the period are disclosed.

The additional disclosures for this statement can further detail the market value of debt as part of determining enterprise value since it will include both on and off balance sheet items that will need to be explained.

Once enterprise value is defined, this statement focuses on determining the split between current and future value. Our proposed approach is effectively to compute the current value

portion of Enterprise Value based on using the WACC to capitalize the Economic Profit of Current Value into perpetuity and then adding invested capital. Current Value is a proxy for the market's valuation of the current operations of the company - i.e., the anticipated future cash flows accruing from the activities the company will be pursuing. Once Current Value is computed, Future Value is then calculated by subtracting Current Value from Enterprise Value. Future Value is a proxy for the capital market's expectations of future growth.

We also recommend presenting the debt to equity ratio as a supplementary disclosure on this schedule since changes in levels of debt will have a direct impact on the equity shareholders.

3. Statement of Total Return to Shareholders (TRS) - Unadjusted

To reconcile Enterprise Value to TRS, the equity portion of Enterprise Value needs to be analyzed to reflect the market's implied valuation of current and future value inherent within the closing period stock price. The Statement of Total Return to Shareholders - Unadjusted (Figure 14) provides the key perspective of the relative impact of current and future value in the closing share price at the end of a period. Further, by using TRS Mapping Framework methodology, company management will have robust analytical tools to support their commentary on the period changes in TRS, based on their improved insight and understanding of the key value drivers and resource types applicable to their business model and industry.

Figure 14 -Statement of Total Return to Shareholders - Unadjusted

XYZ Corporation Statement of Total Return to Shareholders (Unadjusted) \$ Millions						
	Prior Year	Change	Change %	Current Year	Change	Change %
Value of EPCV in perpetuity	\$ 1,004.3	\$ 454.6	83%	\$ 1,711.0	\$ 706.7	70.4%
Invested Capital	7,721.5	(326.4)	-4.1%	9,857.9	2,136.4	27.7%
Less: Capital Subordinated to Debt	\$ 6,487	\$ (502)	-7.7%	\$ 8,545	\$ 2,058	31.7%
Capital Available to Equity Holders	\$ 1,235	176.05	16.6%	\$ 1,313	78.02	6.3%
Current Value in the Market Value of Equity	\$ 2,239	630.66	39.2%	\$ 3,024	\$ 785	35.0%
Future Value in the Market Value of Equity	\$ 7,120	(5,613.99)	-44.1%	\$ 14,264	\$ 7,143	100.3%
Market Value of Equity	\$ 9,360	\$ (4,983)	-34.7%	\$ 17,288	\$ 7,928	84.7%
Number of Equity Shares Outstanding (in Thousands)	321.97			324.65		
Close Share Price of Equity Shares	\$ 29.07	\$ (15.86)	-35.3%	\$ 53.25	24.18	83.2%
Dividends Received in Period		\$ -			0.40	
Total Return to Shareholders (Unadjusted)		\$ (15.86)	-35.3%		\$ 24.58	84.6%

4. Statement of Total Return to Shareholders (TRS) - Adjusted

The final EBR statement reconciles the TRS performance with the overall stock market movement to present company TRS performance against overall market performance in the period (Figure 15 - next page). The S&P 500 index is used as the basis of overall stock market movement. Alternatively, other relevant industry-based market indices could be used.

Figure 15 -Statement of Total Return to Shareholders - Adjusted

XYZ Corporation Statement of Total Return to Shareholders (Adjusted) \$ Millions				
	Prior Year	Change %	Current Year	Change %
Adjusted Closing S&P 500 Index	841.95	-31.4%	1,144.94	36.0%
Beta	0.8		0.7	
Predicted company return due to market movement		<u>-25.2%</u>		<u>25.2%</u>
Total Return to Shareholders (TRS)		-35.3%		84.6%
Better/(Worse) than predicted on market movement		<u>-10.1%</u>		<u>59.4%</u>

The market return in the period is adjusted by the company's Beta as the basis for the predicted company shareholder return in the period. The predicted shareholder return is then compared to TRS to compare the company's performance relative to the market. Again, using TRS Mapping methodology, company management will have the analytical tools to support their commentary on this variance.

Please note that it is of critical importance to comprehensively disclose the methodologies and sources of Beta.

Similar to traditional financial reporting, there would be supplemental disclosures and MD&A for each of the EBR statements to enhance overall financial disclosure by providing users with a comprehensive economic perspective of the company. Similar to the use of estimates in accrual accounting, there will also be judgment involved in calculating certain requirements (i.e., WACC), however as long as the methodology or source is adequately disclosed, the EBR users will have rich information available to use as they deem appropriate. The EBR supplemental disclosures would provide the necessary supporting details such that every calculation and key assumption would adequately inform both sophisticated and basic users.

Part II: Operational Reporting Framework Proposal for EBR Statements⁷

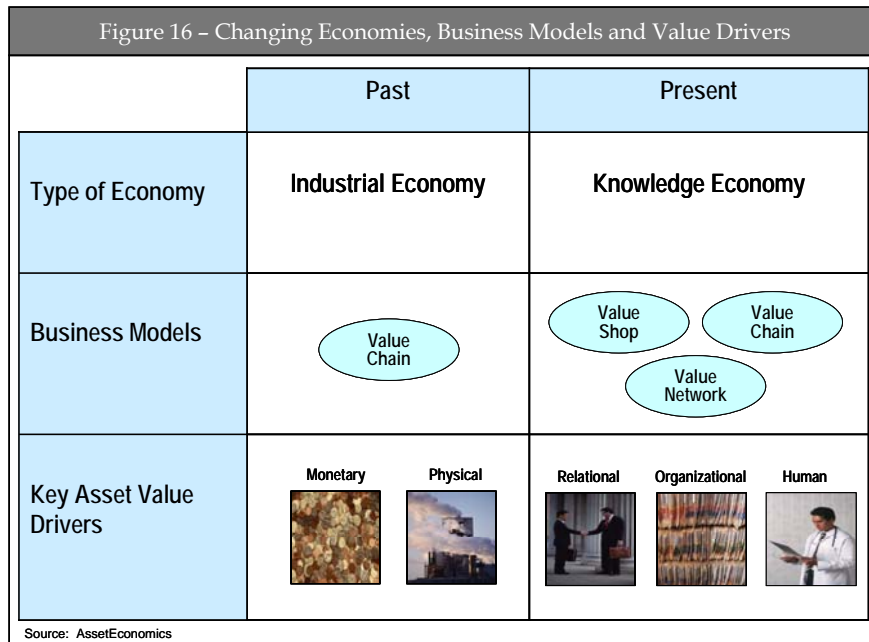
To complement the TRS Mapping Framework, EBR reports, the MD&A and FLS would be extended to provide explanations and metrics, using economic principles, for the year over year changes within each EBR statement. Accenture's TRS Mapping Framework methodologies and Total Economic Profit measurement concept provide the foundational analyses for this enhanced management commentary.

Today's equity investors - in some cases exclusively - rely on equity analysis research for insightful commentary and analyses on the underlying economic performance of a company relative to both its historical results and peer group. Mostly this is provided by sell-side

analysts. The proposed EBR statements and related MD&A and FLS information will enable management to directly present the relevant content for analysis for all its stakeholders, greatly improving the interpretability of existing statutory financial reporting.

Changing Economies, Business Models and Value Drivers

For the past 25 years, the economy has been undergoing a metamorphosis – from an industrial economy to a more knowledge-based economy. This significant change has created new business models and different value drivers. The past is typified by an industrial “value chain” business model based upon traditional monetary and physical resources and conducting input-prices-output related activities. The idea of the knowledge-based economy is coincident with two business models that have increasingly emerged as important economic business models – the “value shop” and “value network” (see Figure 16).



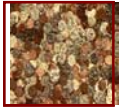




The value shop’s function is to create a solution to an external (e.g., client or partner) business problem by mobilizing the right mix of resources (human, monetary, information) with the right skill sets to properly diagnose and ultimately solve a particular problem creatively and in a timely manner. IDEO, the Palo Alto, USA California-based creative design shop, represents a prime example of a classic value shop.

The value network brings buyers and sellers together as efficiently as possible for the exchange of goods via some network-based communication and mediation system. Value is created in the Value Network model by identifying new customer sets for sellers and vice versa with the types of products those customers are looking to spend money on. eBay, the San Jose, USA California-based Internet auctioneer, represents a prime example of a classic value network.

Both the value shop and value network derive value from intellectual capital resources -- existing and new relationships, organization processes and the inherent knowledge, skill and talent of their people. The value chain creates shareholder value by maximizing the internal margin characteristics, and by knowing and effectively managing cost structure. In value shop and value network business models, shareholder value is created – that is, defined or assigned – by the benefactors of their solutions.

Each of three different business models (value chain, value shop and value network) is dependent upon a completely different mix of value drivers to establish sustainable competitive advantage (Figure 17). Traditional industrial age companies (typically but not exclusively found in manufacturing, retailing, and the like) operating under a value chain business model seek to build sustainable competitive advantage primarily based on their effective use and exploitation of their monetary and physical resources. In contrast, the value shop leverages its human resources as its primary means for competition while the value network, on the other hand, derives value primarily from relational and organizational resources which speak to the communities and processes they have that are uniquely able to be differentiated from their competitors.

Figure 17 – Business Models, Value Drivers and Competitive Advantage

Asset Form	Chain	Shop	Network
Monetary 	Primary Basis for Competitive Advantage		
Physical 	Primary Basis for Competitive Advantage		Secondary Basis for Competitive Advantage
Relational 	Secondary Basis for Competitive Advantage	Secondary Basis for Competitive Advantage	Primary Basis for Competitive Advantage
Organizational 	Secondary Basis for Competitive Advantage	Secondary Basis for Competitive Advantage	Primary Basis for Competitive Advantage
Human 		Primary Basis for Competitive Advantage	

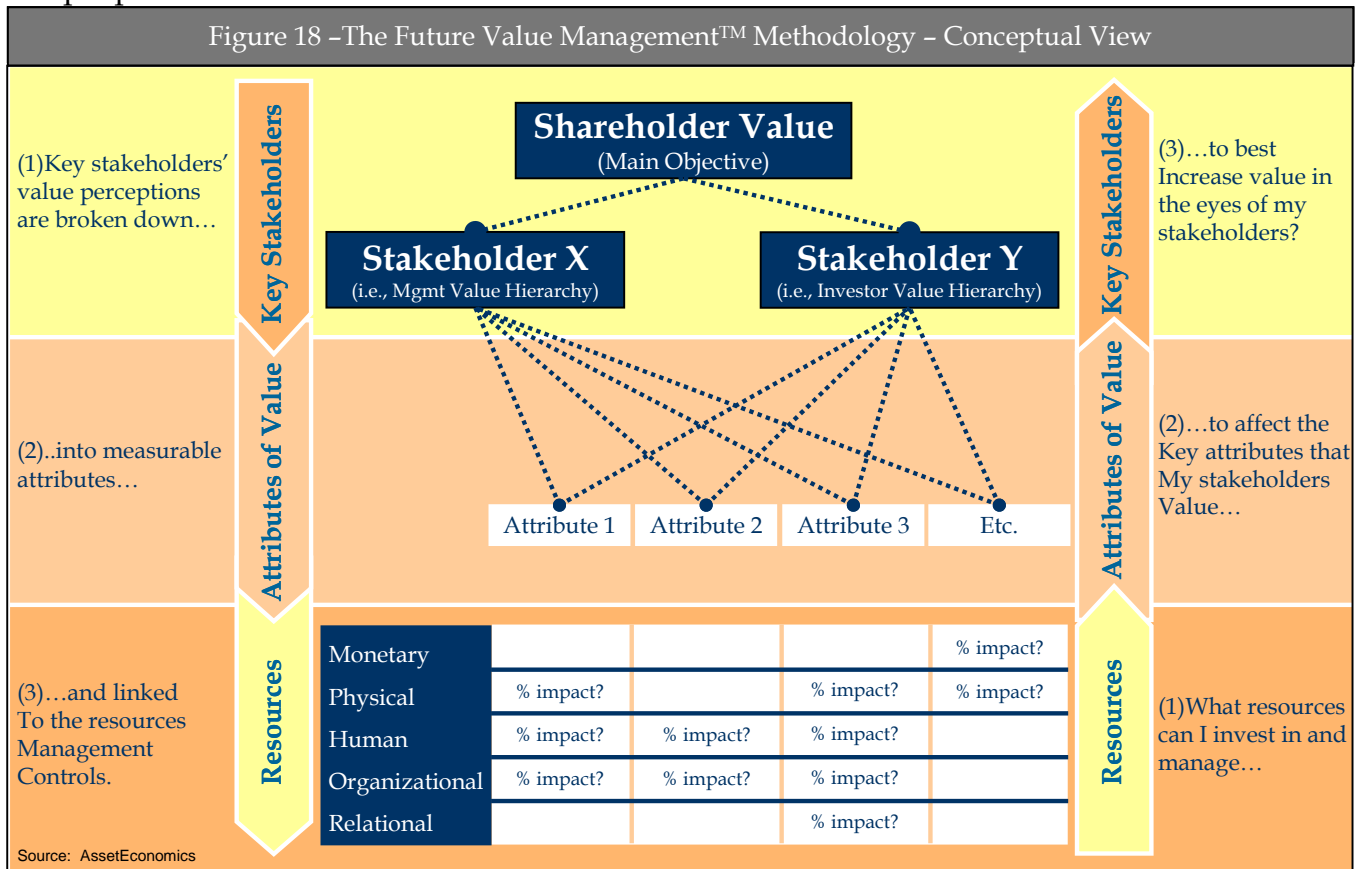
Source: AssetEconomics

It can be noted too that all three business models leverage a secondary resource form to help establish and/or bolster their competitive advantage. In the value chain and value shop business models for example, both relational and organizational asset forms are called upon for secondary competitive advantage whereas the value network leverages these resources as its

primary basis for competitive advantage. The physical resource form is used by the value network as a secondary basis for competitive advantage whereby the value chain leverages both physical and monetary asset types as its primary means for competitive advantage.

The Future Value Management™ Methodology

To effectively manage all aspects of value for today’s high performing company, managers at the helm need a sophisticated holistic methodology that will provide comparable consideration to all resource forms – monetary, physical, relational, organizational and human. The Future Value Management™ Methodology (Figure 18) has been developed by AssetEconomics to serve this purpose.



To begin, all resource forms are located at the core of the model and are linked to those key attributes that shareholders value. The model is not partial to the traditional view of monetary and physical resources and, therefore, it is not necessarily predisposed to the logic of the value chain. The methodology will therefore provide insights on what to manage, how, and what potentially to report on no matter how the enterprise is structured. The ultimate goal is to build shareholder value regardless of whether the increase comes in the form of (sustainable) current or future value. Hence, the model will not sway stewardship one way or the other.

The methodology begins with stakeholder perceptions about what is valued and ends with actions that will affect those perceptions.

What is at the heart of this is a simple logic but one that is often missed by managers and academics alike. The logic is this. For any enterprise, certain attributes will identify its value to the stakeholder. What attributes are being valued, and how much value is being ascribed to which attributes is a key understanding for the top management group. However, it is essential that it be understood that it is these attributes that are the outcomes of management's actions in relation to the resources at hand and the activities taken in relation to them (how they are combined to create new resources and how they are turned into cash).

For enterprise management then, it is vital to know the attributes by which they are being valued, particularly by their existing and potential investors, and be able to answer the following questions:

1. What attributes are being valued?
2. How much are they being valued?
3. What the response function looks like for each primary value determining attribute?
4. How the enterprise's performance is on the relevant attributes?
5. What improvement in value will come from performing better on which attributes?
6. What reduction in value will come from performing worse on which attributes?

However, this is not all there is.

Enterprises do **not** manage attributes. They manage **to** attributes. What enterprises manage are resources and activities that deliver performance on value determining attributes.

For enterprise management then, it will be vital to understand the nature and (resource and activity) content of the mega value creating processes that represent its business model(s) and be able to answer the following questions:

1. Which are the end-to-end mega processes that impact our primary value determining attributes?
2. Have we mapped these end to end?
3. What are the resources (assets and capabilities) that are being utilized by these processes?
4. What are the activities that result in the transformation of these resources into other resources and/or cash?
5. What resources and capabilities are we vulnerable to?
6. What resources and capabilities do we need to grow or diminish into the future (given our strategic intent)?
7. What activities do we need to introduce to improve performance?
8. What activities do we need to manage differently, how, to improve performance?

There are clear implications for EBR. Management teams will need to:

1. Understand their own business model(s) before they can begin the process of identifying what to manage to and what (potentially) to report on. An understanding of the business model archetype(s) will point management toward the resource and activity types that will likely underpin their strategies.
2. Identify their valued attributes and the weightings that investors are putting on these.
3. Establish the mega value creating processes that impact their valued attributes. This will reveal the resources and activities that matter.
4. Establish performance metrics that relate to attributes, resources and activities.
5. Determine how these metrics are going to be used internally.
6. Decide what information on attributes, resources and activities should be disclosed to the market under what conditions, when and why.

Clearly, this very last consideration is not a trivial one since any disclosure may be used competitively, especially in mature industries where one's competitors may not be participating in the same capital markets and may not be subject to the same regulatory imposts or legal consequences, nor have the same requirements for disclosure.

Reporting on Operations

Our Operations Reporting Framework for EBR requires that four tasks are completed:

1. Identify the firm's key shareholder value determining attributes
2. Establish the end-to-end mega value/attribute driver processes
3. Detail the resources and activities (and decisions) that prescribe the mega value/attribute drivers
4. Establish and report on the relevant attribute, resource and activity metrics

Assuming that management wants to inform its investors fully about its current performance and future prospects on a continuous basis, it will be imperative to develop metrics that cover the three performance areas of attributes, resources and activities and to do this with metrics that reflect the future, the present and the past. AssetEconomic's '4Cs' of measurement and reporting criteria - **comprehensiveness, consistency, coherence and comparability** will also need to be observed if EBR is to be meaningful.

We will use eBay Inc. and a made-up fundamental attribute - "Buyer/Seller Satisfaction with PayPal" as an example to first, illustrate attribute mapping at an abstract level in order to identify the attribute's associated resources and activities, and second, to identify and represent performance measures that are reflective of the attribute's (i) causally linked resources and activities and (ii) forward-looking performance prospects.

eBay today (2Q04, June, 2004)⁸ has 114.0 million Registered Users⁹ and 48.0 million Active Users¹⁰. The auction site had some 332.2 million listings for 2Q04. Gross Merchandise Sales (GMS) were \$8.0 billion for 2Q04, implying an annualized GMS of \$32.0 billion. PayPal, eBay’s transaction facility, had 50.4 million accounts and 15.5 million active accounts at the end of 2Q04. PayPal is listed as a payment option vehicle on most of eBay’s transactions, although using PayPal is not mandatory (a number of payment options exist). PayPal transaction volume was 77.7 million transactions for a value of \$4,350 billion, representing some 50% of payments¹¹ for 2Q04.

Clearly, buyer/seller satisfaction with PayPal is a fundamental attribute in its utilization. This attribute is clearly the result of buyer/seller security requirements of the system and its

Figure 19 –Possible Attribute Listing for eBay

#	eBay Attribute
1	Use of Community Feedback
2	Current System Capacity
3	System Functionality
4	Buyer / Seller (Trader) Satisfaction
5	Power Seller Satisfaction
6	Prohibited Item Sales Policy and Management
7	Buyer/Seller Satisfaction with PayPal
8	Category Coverage
9	Advertizing Effectiveness
10	Potential Size of User Base
11	Growth in Sale Category/ies
12	User Growth
13	Fraud & Counterfeit Exposure
14	Innovativeness
15	Level of Awareness in Countries
16	Alternative Choice/s in the Market for Users
17	Community Activity
18	Potential User Size
19	PayPal Functionality (including Capacity)
20	On-Line Advice Effectiveness
21	Contractor Management
22	Legal Recourseability
23	Safe Harbor Use
24	Platform Development Rate
25	PayPal Development Rate
26	Call Center Effectiveness
27	Foundation Activity
28	Green Credentials

Source: AssetEconomics

performance in relation to these requirements as well as the system’s functionality and capacity.

Step 1 is to identify the firm’s key valued attributes. Figure 19 illustrates what these attributes might be for eBay. We have selected one of the attributes - “Buyer/Seller Satisfaction with PayPal” - to further develop the Operations Reporting Framework content.

Step 2 is to identify the attribute’s causal determinants, the resources (and implied activities) that impact it.

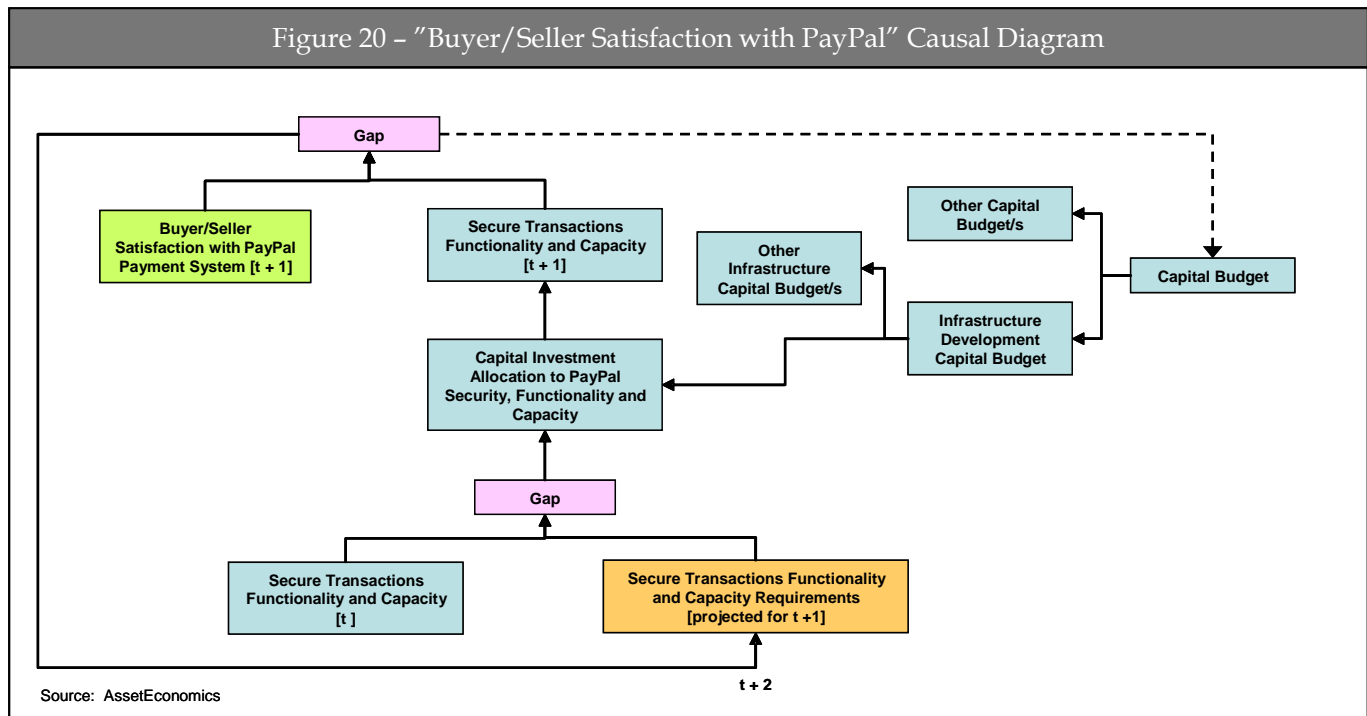
Typically we begin with a potential performance gap, seek to close this gap (since performance on the attribute is fundamental to enterprise performance and therefore valuation) and come back to the performance gap. This structure is used in Figure 20 (next page) for the attribute “Buyer/Seller Satisfaction with

PayPal”. The resource structure that is causally linked to this attribute is identified. Resources

are identified in blue, the gaps in pink, the attribute “Buyer/Seller Satisfaction with PayPal” in green and the “new” requirements for security, functionality and capacity in brown.

The Operations Value Drivers Template summarizes the key performance measures for each mega value creating process in the organization. Typically we would expect to find somewhere between six and twelve of these mega value creating processes for each major SBU within a large enterprise. The objective here is to capture, at a Pareto level of detail, the measures that provide fundamental insight into the operations of the business and its cash flows. A separate Operations Value Drivers Template should exist for each mega process impacting one or more of the firm’s valued attributes.

Please note that Figure 20 illustrates a highly abstracted “causal path” leading to buyer/seller satisfaction with PayPal. This causal path is neither complete nor necessarily accurate for eBay. The example has been prepared to demonstrate the principles involved in implementing an Operations Reporting Framework.



Step 3 is to identify the key resources and implied activities that represent the beliefs represented in the causal diagram that link these resources and activities to the key attribute. These are shown in the table in Figure 21 for our chosen attribute.

Although this table can be regarded as a different way of representing the causal diagram shown above in Figure 20, it has an important added feature in that it makes explicit the activities that have to occur in order to deploy and transform resources from one form into another in order to improve performance on the attribute we are interested in. In this case we

are transforming cash (a resource), through (say) contracted software development (an activity), into an improved secure PayPal transaction capacity (a resource). Understanding this sequence is vital, since we need to both measure activities as well as resources in order to provide a complete view on our future performance, prospects and value.

Figure 21 - "Buyer/Seller Satisfaction with PayPal" Attribute Value Driver Template

Attribute	Defining Attributes	Resources	Activities
Buyer/Seller Satisfaction with PayPal Payment System	Security	PayPal Software Platform	Platform Continued Development
	Functionality	Software Development Team	Software Developer Recruitment and Retention
		Capacity	Software Developer Contractor Management Skills
		Software Development Protocols	Protocol Development, Integration and Distribution
		Server/s	Data Storage Forecasting and Hardware Provisioning
		Data Storage	Identity Theft Protocol Development
		Buyer/Seller Identity Protection Protocols	Dispute Resolution Refinement
		Customer Services On-Line	PayPal Usage Monitoring and Intelligence Gathering
		Customer Services Telephone	PayPal System Functionality Requirements Forecasting
		Customer Services Email	Transactions Record Archiving
		Dispute Resoution Procedures - Purchases	Transactions Quality Assurance - Buyer/Seller Research
		Dispute Resolution Procedures - Returns	PayPal System Change Introduction
		Credit Card Provider Relationships	International systems and integration

Source: AssetEconomics

Step 4 is the final step, and involves selecting the most informative (information-laden) performance measures for the firm’s external information users.

The Operations Reporting Template (Figure 22 - next page) provides an indication of the temporal perspective on the measures that are to be reported on.

Figure 22 – Operations Performance Reporting Template with Content only For “Buyer/Seller Satisfaction with PayPal”

		Performance Measures		
		Leading	Current	Lagged
Attributes		<ul style="list-style-type: none"> Capacity availability relative to growth requirement cushion Capacity, functionality and security expansion and improvement plan specs. Initiatives taken with relevant agencies to prevent security breaches at (i) individual and (ii) PayPal system levels (e.g., with Internet Fraud Complaint Center, the partnership between FBI and National White Collar Crime Center) 	<ul style="list-style-type: none"> System availability PayPal performance complaint inventory (types) Nature of new scams Nature of new complaint types Escalation rate(s) of performance complaint(s) (by type) 4P - prevention, protection prosecution and pursuit activities 	<ul style="list-style-type: none"> System availability performance over period Buyer / seller satisfaction with PayPal functionality Number of occasions and length of time capacity safety limits reached Number of occasions PayPal system "invaded" Number of "proven" occasions of advertant identity theft Number of "proven" occasions of inadvertent identity theft Number of "proven" scams Seriousness of "proven" scams
	Resources (Assets or Capabilities)	<ul style="list-style-type: none"> PayPal platform requirements plan specs. PayPal CRM process plan specs. Data storage security benchmark 	<ul style="list-style-type: none"> PayPal platform software IP PayPal functionality vis-à-vis user requirements domestically, x-border PayPal development protocols PayPal Customer Relationship Management (CRM) enabling tools (email online, telephone) Trained CRM staff numbers Credit card provider relationships Dispute resolution process 	<ul style="list-style-type: none"> PayPal platform investment performance
	Activities (Processes)		<ul style="list-style-type: none"> ID theft pursuit success Scam pursuit success Percent transactions offering PayPal (domestic, by country) Percent transactions completed with PayPal (domestic, by country) 	<ul style="list-style-type: none"> Software developer recruitment vis-à-vis requirement performance Software developer churn Software development testing acceptance Software update / change-over implementation performance User requirements forecasting performance PayPal change implementation disruptions
		Source: AssetEconomics		

The template is based on a simple partitioning of lead, current and lag measures and/or indicators for (valued) attributes, and (value determining) resources and activities. This summary template, which of course would not necessarily have information in each cell for any one attribute, nonetheless forces a consideration of what the measures are that can be developed

and reported on that will, in fact, provide forward-looking information for relevant stakeholders - our "Leading Performance Measure" column.

Completing this template and thinking through the information value content is fundamental to EBR since it is unfortunately the case that virtually all performance measurement systems provide only lagged information and further that many measurement systems reflect only lagged process performance information (for e.g., the elapsed time to answering a telephone call in a Customer Call Center as an indicator that customers are well served).

The template would, of course, contain the measures for all of eBay's key valued attributes and not just for our illustrative attribute. The decision for eBay would be to choose those attribute, resource and activity metrics that provide the most meaningful information for shareholders and their advisers.

The AssetEconomics Future Value Management™ methodologies can establish the relevant attributes, resources and activities that matter for value creation for any enterprise. Accepting this for the moment (for the purpose of argument and the intent of our proposal), it will then follow that a parsimonious set of performance metrics can be reported on that will provide a high level of informational content about the enterprise and its potential future.

Part III: Summary

In order to summarize our approach, we compare our FVM™ methodology to the traditional DuPont approach to identifying, measuring and managing value drivers. This is shown in Figure 23.

Figure 23 - Answering the key management questions - Comparing the FVM™ Methodology to Traditional Approaches			
Key Management Questions	Typical Approach	Issues with Typical Approach	FVM™'s Solution
What are the key value drivers of my business?	<ul style="list-style-type: none"> • Intuition • Classic DuPont financial analysis • Focus on traditional accounting assets 	<ul style="list-style-type: none"> • Not comprehensive (lack of proper consideration of intellectual capital) 	Takes into account all resources, traditional accounting and intellectual capital, in an integrated manner
How do I determine what Value drivers have the largest impact?	<ul style="list-style-type: none"> • Intuition • Spreadsheet analysis • Classic finance & accounting metrics 	<ul style="list-style-type: none"> • No feedback among variables • Relationship among drivers is not linear in reality • No account for time delays 	Modeling is dynamic allowing For feedback and time delays To be understood
How do I make the optimal trade-offs regarding strategies and resource allocations?	<ul style="list-style-type: none"> • Intuition • Non-comprehensive spreadsheet analysis • Usually one point of view considered 	<ul style="list-style-type: none"> • Ineffective in all but the most simple of business models • Cannot handle complexity over time 	Combination of above, with An understanding of value Perceptions of key stakeholders, Allowing for a more optimal Trade-off analysis

Conclusion

It has been clear for some time that day-to-day volatility as a secular trend has been increasing in the equity markets. This has made both the management and disclosure decisions by enterprise managers and investors more challenging. Less apparent – but far more impactful – has been the steady uncoupling of equity value drivers and contemporary GAAP practices. As we have indicated, as much as \$7.6 trillion in US equity value may as a result be at risk.

The marketplace and interested stakeholders will eventually *choose* how accounting will address questions about definitions, procedures and ways of reporting on frontier accounting issues such as intellectual capital, intangibles, and future value. In the meantime, our EBR proposal demonstrates that it *can* address them. In a 2001 letter concerning New Economy Reporting, the SEC's Chief Accountant wrote to AICPA: "A characteristic of high-quality financial reporting is that the information is comparable, verifiable, and provided on a consistent basis from period to period."¹² We suggest that our EBR proposal meets all these criteria, in a comprehensive, straightforward, and widely applicable way.

We have detailed an integrated system of EBR concepts and application frameworks and methodologies. In our extensive experience with all of AICPA EBR stakeholder groups, all are necessary for EBR to move forward.

Our concepts and application frameworks, based on extensive research, propose a number of measurement ideas that extend the abilities of GAAP-based accounting to capture, report and thus manage new and heretofore under-managed drivers of shareholder value. Our specific recommendations for new reporting practices distill those concepts into actionable data that can serve both specialists – enterprise managements and institutional investors, for example – and individual investors. Lastly, the proprietary application methodologies and tools we have woven into our proposal demonstrate that the EBR practices we recommend are in fact well within the managerial reach of listed companies.

#

Notes and References

- ¹ Daum, Jurgen H. Intangible Assets and Value Creation, page 43, John Wiley and Sons.
- ² It is noted that the SEC has made concerted efforts in recent years to elicit MD&A that is informative and transparent. Indeed, the purpose of the MD&A is not complicated. It is to provide reader with information that is “necessary to an understanding of a company’s financial condition, changes in financial condition and results of operations”. MD&A requirements are intended to satisfy three principal objectives:
 1. To provide a narrative explanation of a company’s financial statements through the eyes of management
 2. To enhance the overall financial disclosure and provide the context within which financial information should be analyzed
 3. To provide information about the quality of, and potential variability of, a company’s earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance.
- ³ www.Accenture.com/Outlook, Future Value: The \$7 Trillion Challenge, John J. Ballow, Robert J. Thomas and Göran Roos, Page 30.
- ⁴ Executive Views on Intangible Assets: Insights from the Accenture/Economist Intelligence Unit Survey, Research Note, Intangible Assets and Future Value, Issue One – April 13, 2004, Molnar, Michael J.
- ⁵ Managing for shareholder value: intangibles, future value and investment decisions, Journal of Business Strategy, Volume 25, No. 3, 2004, pp. 26-34, John J. Ballow, Roland Burgman, and Michael J. Molnar.
- ⁶ Part I reflects the intellectual property of Accenture LLP.
- ⁷ Part II reflects the intellectual property of AssetEconomics Inc.
- ⁸ Data taken from eBay’s Second Quarter 2004 announcement, “eBay Inc. Announces Second Quarter 2004 Financial Results”.
- ⁹ eBay defines a Registered User as “cumulative confirmed registered users”.
- ¹⁰ eBay defines an Active User as “the number of users on eBay’s platform who bid, bought or listed over the trailing 12 months”.
- ¹¹ The percentage of Gross Merchandise Sales can not be calculated accurately since the transaction volume includes reversed, rejected and pending payment attempts as well as successful payments.
- ¹² FASB: “Business and Financial Reporting, Challenges from the New Economy” (April, 2001). Executive Summary, p.71 www.fasb.org/articles&reports/sr_new_econom.pdf.)