Five Quick Wins

If the investment community were in charge of the evolution of reporting, what would they change?

The participants in the global CRUF community have been talking at some length about the usefulness of reporting today. Through their discussions, they have identified a number of areas where financial statements are not meeting the needs of the capital markets. Some of the topics highlighted through the CRUF's debates would require a fundamental review of existing accounting standards. However, a number of the most commonly cited frustrations could be resolved today through voluntary disclosure by companies.

This document highlights just five of the CRUF's most commonly cited "quick wins". The intention is to focus on the pragmatic rather than rehearse conceptual debates. It is hoped that areas identified could be addressed by most companies without significant incremental cost. However, the CRUF recognises that this will not be universally true. Similarly, it recognises that there will be companies for whom elements of this list will not be relevant. And so the Forum wishes to stress that it does not wish companies to view this as yet another check list; its ambition is simply to offer some feedback on the effectiveness of some areas of reporting today.

Five Quick Wins

1. Segmental

As investment professionals, we typically build our models from the "bottom up" and so rely on management to provide the financial and non-financial metrics that will allow us to forecast financial performance for a segment and to compare the operational performance and valuation metrics of a given segment against similar entities.

To do this, the CRUF encourage management, where possible, to consider including the following lines in their segment disclosures, particularly where such information is available as management is already using them to assess segmental performance:

- Revenue
- Op profit (or a similar measure)
- Share of results of associates and JVs (income statement data)
- Depreciation and other non-cash expenditure
- Operating cash flow
- Cap ex
- PP&E
- Operating net assets
- Share of net assets of associates and JVs (balance sheet data)
- Working capital
- Debt
- Total assets and liabilities
- Capital employed

We would like to stress "through management's eyes" metrics – both financial and non-financial, and those that are required by IFRS 8 and are incremental, are most useful if they are reconciled to the IFRS basis used in the group accounts.

Whilst the CRUF welcomes a "common sense" check on the number of segments separately identified so they are not unreasonably numerous, where practicable, we encourage management to use the "business model" as the "unit of account" when deciding on the primary segmental split so that reported segments do not contain very dissimilar business activities.

2. Net debt reconciliation

The CRUF strongly encourages management to provide a net debt reconciliation.

A net debt reconciliation allows us to assess how business financing has changed over time. Without it, we are left struggling to understand the impact of FX movements arising on debt, the value of debt acquired or disposed of in business combinations, the impact of fair value and fair value hedge adjustments, whether the increase in cash balances can be explained by a commensurate increase in debt, and so on.

As "net debt" is not defined under IFRS, we would also encourage companies to make clear how they calculate the figure and reconciling each component, and for companies to remain consistent in that definition from year to year, where possible.

3. Debt

The economic downturn and continued strain on the availability of financing have resulted in an increased focus on cash and an entity's ability to fund working capital requirements, refinance existing debt and secure new debt. What are management's plans for servicing existing debt and are there any risks associated with this? For investors to feel more comfortable with an entity's funding arrangements, the CRUF encourage companies to:

- Provide greater detail on maturity schedules – for example, it would be helpful if management provided the debt repayments that fall due in each year (for a minimum of 5 years) rather than sticking to the buckets identified, as an example in IFRS7, of "less than 1 month, 1-3 months, 3 months to 1 year and 1 – 5 years".

- It is most frustrating that, as IFRS7's requirement that the maturity schedules include gross contractual amounts including interest, we cannot always relate the numbers presented in the maturity schedules to the carrying values in the balance sheet. We would be most grateful if companies could help us tie the two sets of data together, showing principal and interest payments separately, and reconciling total gross payments to the balance sheet (ie showing adjustments for discounting, fair value hedge adjustments, fair value option adjustments etc.)

- Although IFRS requires management to report on any defaults or breaches of loan agreement terms that are not resolved by the period end, we would value additional information about the principal covenants – their terms and any restrictions in place.

- In similar vein, we would appreciate clearer disclosure of any restrictions on the repatriation of cash that might impede the ability to meet future financing needs.

- As the investment community is interested in the underlying economic flows of a business, we encourage companies to provide better disclosure of the effective interest rates that they face and the effective currency of debt obligations.

4. Cash disclosures

Whilst the talk on conference calls and in investor presentations may focus primarily on lines from the income statement, to understand the quality and sustainability of performance we need to be able to tie across the key lines of the primary statements.

Given that most analysts will use the operating line in the income statement in analytical models, the CRUF would encourage companies to help us to tie across the statements by starting the cash flow statement at an operating line.

We would also welcome more detailed descriptions of the adjustments made to derive operating cash flow so that they can be more easily related to items on the balance sheet (eg changes in significant components of working capital assets and liabilities, differences relating to various provisions such as pensions, asset retirement obligations, derivatives, etc).

If possible, we would appreciate the capex line being split into maintenance, growth and acquisition spend.

We would also welcome greater clarity about non cash transactions and how they affect the cash flow statement (eg new finance leases, non-cash contributions to pension trusts, non-cash consideration in a business combination). Summarizing these would provide clearer context for the analysis of amounts that are reported as cash flows.

5. M&A

M&A activity is on the increase. Given the size and significance of many of these transactions, we encourage management to provide us with enough information to assess the value created through such activities. In the absence of some clear description of how value has been extracted from the significant sums invested in M&A, it is hard for investors to have confidence that the return on such investment is sufficient.

To do this, we would welcome:

- A clear disclosure of the total consideration paid for an acquisition (including the debt acquired, pension liabilities assumed etc).

- A clear description of the intangibles acquired. In particular, we would like to be able to distinguish between those acquired assets that have a finite life (eg a patent) and those that are sustained through expenditure that goes through the income statement (eg customer lists and brands). This will allow us to determine whether we wish to reverse the associated amortisation charge or not.

- Management will typically discuss the strategic rationale for any acquisition made. However, once the acquisition has been finalised, it can be difficult to assess whether the stated strategic ambitions have been met. We would welcome clear disclosure of the financial returns from the acquired assets or businesses. However, we recognise that integration often means that it is sometimes difficult to identify returns specifically attributable to them. In the absence of such information, we appreciate any insight – perhaps through non financial metrics – that companies can bring regarding the skill and discipline with which they manage acquisitions.