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Investor view

Insights from the investment community

Issue 2 - Net debt reconciliation

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The first issue in the 'Investor view' series highlighted some of the key points raised by members of the Corporate Reporting Users' Forum at the 'Meet the Experts' conference in London. At the top of the list of reporting areas that investors considered could be improved was the *net debt reconciliation*. This edition of 'Investor view' provides a high-level overview of the reconciliation and the benefits it can provide to users of the financial statements in their assessment of an entity's liquidity and solvency.

What is a net debt reconciliation?

A net debt reconciliation shows how a company's indebtedness has changed over a period as a result of cash flows and other non-cash movements. It typically takes the form of a reconciliation to items in the cash flow statement; however, for clarity it should not be incorporated within, or be an extension of, the cash flow statement itself.

A net debt reconciliation is not required under IFRS/Ind AS or Indian GAAP. However, some entities choose to include this information.

Why is it useful to investors?

A net debt reconciliation allows investors to see how business financing has changed over the year. It is an easy way of assessing whether an entity that on the surface looks to have had a significant increase in cash has, for example, achieved this only by taking on a corresponding increase in debt. It can also highlight:

- Debt acquired or disposed of in business combinations;
- Foreign exchange movements arising on debt; and
- Information that is not always obvious elsewhere in the financial statements.

However, investors tell us that, even where a net debt reconciliation is provided, certain key items are frequently omitted. Such items may include the impact of foreign exchange translation and the separate disclosure of acquired (or divested) debt as distinct from other financial liabilities.

How is net debt defined?

Net debt generally includes the entity's borrowings, including finance leases, less cash and cash equivalents. Some entities also include deficits on defined benefit pension plans and an adjustment for operating lease obligations. The inclusion of other debt-like liabilities provides additional insight into significant expected future cash outflows of the entity. This variation means that it is important for management to explain clearly what it means by net debt.

What does it look like?

The following extracts from the 2008 annual report of GlaxoSmithKline plc provide an example of a net debt analysis and net debt reconciliation. The group also published a maturity profile of the available debt, which has not been included below.

GlaxoSmithKline plc

Net debt	*2008 £m*	*2007 £m*
Cash, cash equivalents and liquid investments	6,014	4,532
Borrowings – repayable within one year	(956)	(3,504)
Borrowings – repayable after one year	(15,231)	(7,067)
Net debt	*(10,173)*	*(6,039)*
Cash and liquid investments	6,014	4,532
Gross debt – fixed	(13,814)	(6,254)
Gross debt – floating	(2,373)	(4,317)
Net debt	*(10,173)*	*(6,039)*

Reconciliation of net cash flow to movement in net debt	*2008 £m*	*2007 £m*	*2006 £m*
Net debt at beginning of year	(6,039)	(2,450)	(1,237)
Increase/(decrease) in cash and bank overdrafts	1,148	1,411	(1,956)
Cash (inflow)/outflow from liquid investments	(905)	39	55
Net increase in long-term loans	(5,523)	(3,276)	–
Net repayment of/(increase in) short-term loans	3,059	(1,632)	739
Net repayment of obligations under finance leases	48	39	34
Exchange adjustments	(1,918)	(88)	(9)
Other non-cash movements	(43)	(82)	(76)
Movements in net debt	(4,134)	(3,589)	(1,213)
Net debt at end of year	*(10,173)*	*(6,039)*	*(2,450)*

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