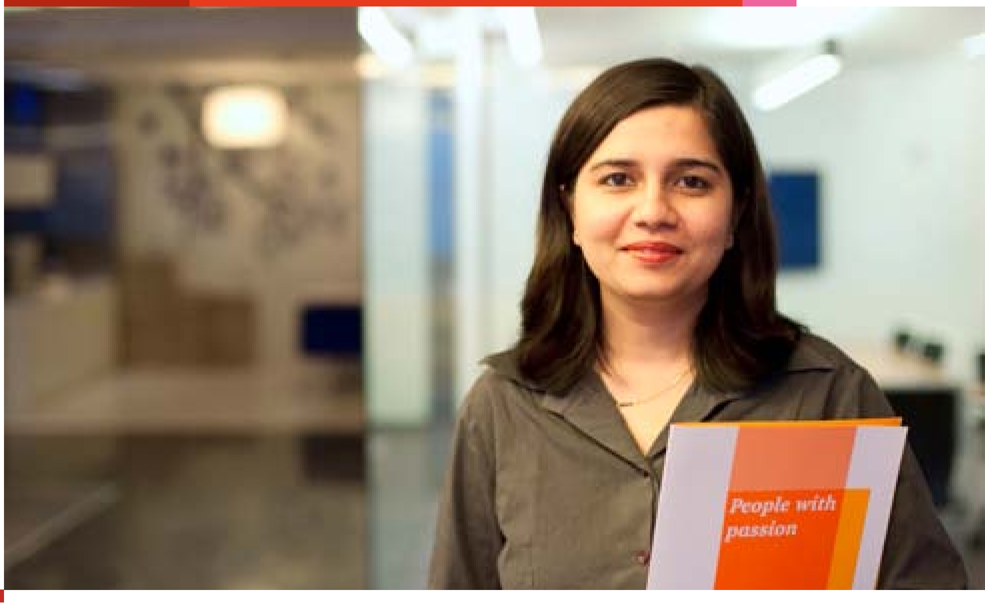
Investor view

Insights from the investment community

Issue 10 - Reconciliations



Reconciliations: linkage within financial statements

Investors and analysts use various types of reconciliations to help them understand the underlying performance of a business. These are important when modelling the business and predicting financial performance – but only if the disclosures provided are useful. This edition of 'Investor view' looks at what reconciliations the investment community wants to see and how disclosures could be improved.

What are the key reconciliations investors use?

Net debt reconciliation - A net debt reconciliation shows how an entity's indebtedness has changed over a period. It allows investors to see how business financing has changed over the year and how the company is managing its resources (see also Investor view 2, 'Investors call for improved net debt reconciliation').

Reconciliation between non-GAAP measures and closest GAAP measures - Non-GAAP measures such as 'EBITDA' (earnings before interest, taxes, depreciation, and amortisation), operating earnings and cash earnings are very commonly used by management to communicate their performance. Non-GAAP measures provide insight into the recurring and non-recurring nature of certain items, which is useful for investors in understanding the underlying operational performance of a business (see also Investor view 4, 'Investors look for improvement in reporting of non-GAAP measures').

Reconciliation of cash tax paid - Investors want to know information on tax payments/ refunds to understand if the taxes paid relate to ongoing operations or one-off items. It is also helpful to understand in what jurisdiction taxes are paid.

Reconciliation of operating cash flow - Cash flow statements can be prepared by either a 'direct' or 'indirect' method; whichever method is chosen, investors want to see how operating income reconciles to operating cash flow. This provides essential data about, for example, changes in working capital and the conversion of profits to cash (see Investor view 8, 'Cash flow disclosure').

Provision reconciliations - A reconciliation between opening and closing provision balances provides information on any new provisions recorded, as well as amounts utilised or released. Investors want to understand, for example, how the cash spent compares to the amount provided for restructuring.

How can disclosures be improved?

GAAP do not require reconciliations for every number in the financial statements; it is management's responsibility to provide information to investors in a way that is useful and relevant. Investors have cited the following considerations for management when preparing reconciliations.

Level of detail - Reconciliations should provide information that is detailed enough to show any material, significant or one-off items underlying movements.

Consistency and comparability - While investors tell us that reconciliations should be flexible and able to adapt to market conditions, it is important to remember the value that users place on trend data.

Clear and consistent headings - Reconciliations should have clear descriptions to enable users to understand movements. Headings should be consistent between the notes and the financial statements to allow for clear linkage. Items should only be classified as 'other' when amounts are immaterial; otherwise, headings should reflect the nature of the item.

Frequency - Investors would like key reconciliations more frequently than in the annual report (that is, quarterly or half-yearly) if the information is material and relevant to understanding the performance of the business.

Distinction between cash and non-cash items - Reconciliations should allow investors to distinguish between items that have a cash impact and non-cash items such as impairments, accelerated charges and fair value movements.

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