26th November 2008

To Finance Directors / Chief Financial Officers

Last month, twenty-six members of the Corporate Reporting Users' Forum wrote to the Financial Times to highlight the need for improved cash flow reporting. A copy of our letter is attached.

One specific area of concern is that some companies no longer provide sufficient disclosure to reconcile cash flow with the movement in net debt. This omission can undermine investors' confidence in their ability to understand what drives debt movements, which is clearly undesirable in current economic environment. Given the focus on cash flow, debt levels and loan facilities, helping investors understand what drives debt movements is more important than ever. We greatly appreciate those companies that do provide this voluntary disclosure and strongly encourage those who do not to follow suit.

Our letter to the Financial Times also mentioned that we are encouraging the IASB and FASB to improve the overall quality of cash flow reporting. The attached "best practice" guide includes some of the enhancements that we have already suggested. The CRUF guiding principles are also included in this document.

CRUF remain committed to maintaining an open dialogue with the corporate sector to ensure that changes in the reporting framework enhance the communication between companies and investors. Further information on issues recently discussed by CRUF can be found at www.cruf.com.

Yours faithfully,

Nick Anderson
Head of Research
Insight Investment

Peter Reilly
European Equity Research
Head of Capital Goods
Deutsche Bank

About the Corporate Reporting Users' Forum (CRUF)

The CRUF was formed in 2005 as a discussion forum with the aim of helping its participants in their approach to the debate on current and future corporate reporting requirements. In particular, participants are keen to have a fuller input into the deliberations of the International Accounting Standards Board.

The CRUF is a discussion forum. Its participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organizations. It does not seek to achieve consensus views, though at times its participants will agree to make joint representations to standard setters or to the media. CRUF participants include individuals from both buy and sell-side institutions, and from both equity and fixed income markets. The forum includes individuals with global or regional responsibilities and from around the world. The CRUF meets on a regular basis in London, Frankfurt and Sydney with facilities for remote participation.

To: The Editor of the Financial Times
6th October 2008

Sir,

In the past two years we have seen voluntary disclosure by some companies improve considerably. As members of the Corporate Reporting Users' Forum (CRUF), we would now welcome better disclosure to assist our understanding of corporate cash flow. The main problems with current disclosure requirements are: first, lack of reconciliation between cash flow and the change in net debt; second, debt at acquired (and divested) companies is not always disclosed, and neither is currency impact on overall debt; third, many line items are opaque, even to experienced investors.

As users, we would like to be able to rebuild the cash-flow statement – in our own preferred format - in a way that reconciles with the balance sheet. Reconciliation of the cash flow to movements in net debt is critical to understanding the cash-flow profile of a business. Only by reconciling cash flows with changes in net debt can users be certain that they have captured all cash-flow movements in their analysis. In our presentation to the International Accounting Standards Board on June 10 (see www.cruf.com), we set out in greater detail our thoughts on good practice in cash-flow reporting.

Historically, the disclosure needed to reconcile cash flow with net debt changes has been available for UK companies. Indeed, the 1997 revisions in the UK to the FRS 1 standard specifically included a requirement to reconcile cash flow in the period to the movement in net debt between opening and closing balance sheets. A survey by the UK Accounting Standards Board demonstrated that this amendment was welcomed by users, companies and auditors alike. The IAS 7, which replaced FRS 1 in 2005, has no such requirement to reconcile movements in net debt, does not require the disclosure of the impact of foreign exchange translation on debt and is sufficiently ambiguous to avoid disclosure of acquired debt.

Nonetheless, a number of companies continue to provide a net debt reconciliation. We estimate that about one half of non-financial FTSE 100 companies provided this information in their latest annual report and accounts. In continental Europe, we believe that the number is substantially lower.

As the US Financial Accounting Standards Board and IASB focus on the presentation of financial statements, we would encourage them to consider the issue of improved cash-flow disclosure. In the interim, we applaud the current voluntary disclosure and strongly encourage other companies to follow suit when they publish their next results.

Yours faithfully

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Insight Investment

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Sarah Deans
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Head of European Equities
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Ralf Frank
Managing Director
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Roger Hirst
Head of London Research
MainFirst Bank AG

Elmer Huh, CFA
Senior Vice President
Enterprise Valuation Group
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Dennis Jullens
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Dr Lothar Weniger
Head of Equity Research
DZ Bank

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Director - Accounting & Valuation
Fidelity Investments

IFRS Cash flow reporting – common complaints and suggested best practice

Common complaints

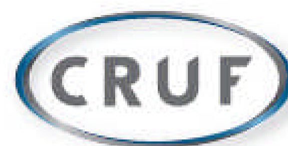
Your company may already provide some or all of these items but most of the following headings are either not required by IFRS or the IFRS requirements are vague:

- Management definition of net debt, reconciled to the balance sheet
- Reconciliation between cash flow statement and net debt movement on balance sheet. This is by far the most important item.
- Debt at acquired companies.
- Debt at divested companies.
- Impact of currency movements on debt
- Treatment of discontinued operations can be very misleading as:
    - Income statement: all revenues and pre-tax profit are removed and only net income from discontinued activities is reported
    - Balance sheet: all assets and liabilities associated with discontinued activities are moved into two summary headings (assets and liabilities). Cash and debt held within these two lines is not separately disclosed (and is in any case highly subjective).
    - Cash flow: discontinued operations are still fully consolidated in cash flow but often scattered across several headings, making it impossible to work out what is going on.

What do investors want? Suggested best practice:

Again, your company may already provide some or all of these details. As well as providing a list of what investors would like, we have tried here to explain *why* investors want these items.

- The overall objective is to understand the cash flow, what is driving it (both positive and negative) and how the cash flow reconciles with the net debt movement. Unless investors have this reconciliation, they cannot be certain that they are not missing something.
- An important part of analysing cash flow is being able to split it into operations, investing and finance in a way that makes sense (as opposed to the format that IFRS imposes).
- Movement in trade working capital, i.e. trade creditors, trade payables and inventories. This very important movement can sometimes be invisible, e.g. when movement in trade creditors is lumped together with movement in provisions.



- Many investors want to track investment in fixed assets by class, i.e. tangible assets, 'organic' intangible assets and intangible assets that are artificially created during an acquisition. For each class they want to know net capital investment so they can compare it with depreciation and amortisation. For example, for tangible fixed assets they want gross capex, proceeds from sales of surplus assets and depreciation. For 'organic' intangible assets, they want gross capex, proceeds from sales (if any) and amortisation of that asset class only (i.e. excluding PPA amortisation).
- Cash outflow on major non-operating liabilities such as one-off pension contributions, material provisions (e.g. restructuring, legacy liabilities) and so on. The simple heading 'movement in provisions' can be very misleading as it can be a mix of cash spent against existing provisions, reversing new provisions that have not been used yet and reversing old provisions that have been written back.
- Cash flow as a result of financial services subsidiaries. The cash flow of companies that have captive financial services operations can be impenetrable as for example investment in lease assets is lumped together with investment in plant and equipment. The cash flow should be presented so that investors can separate operating and financial services cash flow.
- Impact of changes in advance payments if applicable. This is especially important when order intake is weak and therefore cash inflow from advance payments is falling.
- Many cash flow headings are opaque, e.g. movement in other liabilities; please explain material non-intuitive headings.
- Explain movements from derivatives such as foreign exchange hedges. This can cause major confusion.
- We have deliberately not suggested a specific format. While the format is not unimportant, it is much more important to disclose the right information in the first place. There is no consensus amongst investors about the 'right' format so we would encourage companies to focus on providing investors with enough information to enable them to model the cash flow in their own preferred format.
- Lastly, remember that the overall aim is to understand the underlying cash flow. Put yourself in the shoes of an investor who has a reasonable understanding of accounting but knows nothing about your company. Could such a person fully understand what is going on and reconcile the movements to the balance sheet?

The Corporate Reporting Users' Forum

CRUF Guiding Principles

Accounting standards that govern the preparation of corporate reports should be principles-based and comprehensible to the financially literate. These standards should not result in outputs that are at odds with economic reality.

Such standards should be based on the presumption that the stated principles are faithfully applied. Therefore standards should avoid unnecessary detailed prescription and not unduly restrict companies in presenting meaningful results that are in accordance with those principles.

Corporate reports should report economic reality.

Accounting standards should require compliance with their spirit rather than their letter so that preparers are required to disclose economic 'substance' rather than accounting or legal 'form'.

Users want transparent and comprehensive disclosures.

Corporate reports should be prepared with the objective of providing a fundamental source of information for investors and creditors on which to base their decisions.

Corporate reports should provide information that is clear, understandable, consistent and relevant.

No single primary statement should take precedence.

Not all information that is relevant for users of corporate reports has to be reflected in the primary financial statements. Some information, such as contextual and non-financial information may best be presented outside the primary financial statements.

Accounting standards should not discourage companies from presenting additional information that is useful to users.

The purpose of the cash flow statement should be to identify and explain cash inflows and outflows over the period. Further, the cash flow and accompanying notes should provide insights into the drivers of maintainable cash flows as well as the trends over time of these drivers.

The cashflow should be capable of comparison and reconciliation with the profit and loss and balance sheet. The impact of acquisitions and disposals on these cashflows should also be clear.

The purpose of the balance sheet should be to reflect the capital invested in the business along with capital adequacy, compliance with legal covenants and stewardship.

The purpose should not be to determine the entity's fair value. Further information regarding the values of individual assets and liabilities (including assumptions and sensitivities), should be provided in the notes.

The purpose of the profit and loss statement should be to identify the returns generated from the capital invested in the business.

The profit and loss and the accompanying notes should clearly differentiate and analyse relevant information, such as: operating performance from financing activities; recurring from non-recurring activities; value changes from trading activities.