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Lab project report: Debt terms and maturity tables

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Lab project report: Debt terms and maturity tables

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Project background

When talking to investors and companies about the areas that they would like the Financial Reporting Lab (the Lab) to cover, debt and cash flow reporting came high on the list of priorities. Reflecting this, the Lab included four related areas of disclosure in its initial list of topics:

- Net debt reconciliations
- Cash flow statements
- Debt terms and economic obligations
- Debt maturity schedules.

The Lab involved the same group of company participants and members of the investment community in discussions across all four topics. The project focused on existing reporting practices and aims to encourage more companies to consider adopting the practices highlighted as helping companies to meet the analytical needs of investors.

This report features the third and fourth topics, and is being published together with a report on the second topic, *Lab project report: Operating and investing cash flows*.

Lab project report: Net debt reconciliations was published in September 2012.

References made in this report to views of 'companies' and 'investors' refer to the individuals from companies and investment community organisations that participated in this project. The term 'investors' is used as shorthand to refer to the investment community participants in this project, which include a broad range of individuals in their capacity as investors or their role in analyst organisations that work in the interest of investors.

Unsurprisingly, investors have different views on certain characteristics of reporting discussed. Where possible, the views have been distinguished by type of investor and their use of reported information, as well as the importance of particular disclosure in light of general economic, market or company circumstances.

While there may be messages in this report for all involved in corporate reporting, the findings were discussed mainly in the context of companies outside of the financial services sector.

Information that investors do not use could be considered to be clutter. However, this project on debt terms and maturity tables has shown the need for more disclosure in this specific area.

What is the Lab?

The Financial Reporting Lab has been set up by the Financial Reporting Council to improve the effectiveness of corporate reporting in the UK.

The Lab provides a safe environment for listed companies and investors to explore innovative reporting solutions that better meet their needs.

Lab project reports do not form new reporting requirements. Instead, they summarise observations on practices that investors find useful to their analysis and encourage companies to consider adopting the practices if appropriate in the context of their own reporting.

Find out more about the Lab including information about other projects at: http://www.frc.org.uk/OurWork/Codes-Standards/Financial-Reporting-Lab.aspx

Do you have suggestions to share?

The Lab encourages readers of this report to provide comments on its content and presentation. As far as possible, comments will be taken into account in shaping future projects. To provide comments, please send us an email at: FinancialReportingLab@frc.org.uk

Summary of project process and observations

Summary of project process

Five companies in the UK that recognise the importance of good reporting offered to participate in this project to have the Lab facilitate investor feedback on the usefulness of their existing published disclosure on debt and cash flows.

The five companies are:

- BT Group
- National Grid
- Royal Dutch Shell
- Vodafone
- Xchanging

The overall objective of this project was to explore various voluntary practices and to identify those that investors found useful, indicating why this is the case and how information is used.

The Lab worked with these companies to:

- develop a list of questions to be discussed with investors; and
- identify illustrative excerpts from their accounts to be used during the meetings with investors.

Comments and thoughts on these were gathered by the Lab in a series of mainly face-to-face discussions with members of the investment community, focusing on their information needs for analysis. Over 30 individuals from 16 investment organisations provided input, covering a wide spectrum of those using reported information.

For further details on the process, see the section of this report on 'Project methodology'.

"We take engagement with shareholders, analysts and the wider investment community very seriously. Our approach is to be open and transparent, and to encourage candid dialogue."

Ken Lever, Xchanging

Summary of project observations

Generally, the investor suggestions summarised in this report are relevant for companies whose net debt is a significant portion of the capital structure, or debt related interest cost is significant to free cash flows. This corresponds to the importance of information used by investors in equity valuation and in analysis of particular issues with debt or liquidity. As a general point, investors shared a feeling that companies could do a better job of explaining how cash shortfalls are likely to be met.

When debt is significant, or if there are concerns over cash flow generation, investors focused on equities and fixed income securities (credit) both have a strong interest in companies disclosing the detailed terms of debt by obligation, as well as information on the overall profile of debt.

Companies that are active in the debt market or will be looking to issue or refinance debt in the near future are likely to find the comments of investors of relevance in preparing for this. Such circumstances heighten concerns over refinancing risk and bring a closer investor focus on debt and cash flows. If refinancing will be in the bond markets, this also raises a new investment opportunity for fixed income investors, and potentially new interest in a company from investors.

Debt terms

Understanding the nature and timing of the ultimate amounts payable emerged as an important factor for investors. To provide this, companies need to disclose information, generally by obligation, including:

- the principal amount of debt;
- the currency of denomination, and the 'economic' currency of the principal if it has been hedged;
- maturity month and year of when amounts are due; and
- the interest rate and the overall interest rate profile, before and after any significant hedging.

With respect to bank facilities, investors highlight the need for disclosure of the terms of:

- facilities drawn and undrawn, including the process for renewal; and
- financial covenants and credit rating triggers.

Disclosure of the carrying amount of debt obligations is essential information given the variety of accounting methods that may be applied.

Some investors also observed that when concerns over debt arise, these may be more readily addressed where the company has previously provided such basic information.

Maturity tables

The following characteristics of tables summarising the contractual maturities of debt were favoured by investors:

- annual maturity amounts for each of the first five years. Greater granularity, for example quarterly amounts for the first two years, and indications of any concentration of maturities after five years, is also useful;
- separate amounts of principal and interest payments; and
- comparison or reconciliation of principal contractual payment amounts to the carrying amount on the balance sheet.

Tables that present the maturity of the balance sheet amount could generally be removed, as long as a maturity analysis of contractual payment amounts is disclosed.

Cohesion of disclosures with the primary financial statements

A recurring theme raised by investors is the need to relate information disclosed in notes or elsewhere back to the primary financial statements. This helps give investors the confidence that in drawing conclusions and building their investment case, they have understood information and relationships between amounts correctly.

The suggestions in this report to provide the corresponding carrying amounts of each debt obligation, and to relate or reconcile contractual maturity amounts of debt to the carrying amount on the balance sheet, illustrate this theme.

The section 'Example disclosures' provides illustrations of many of the reporting practices noted by investors, taken from the published annual reports of the companies participating in this project.

For further details of the observations made by investors see the section 'Investor observations'.

Next steps

Companies are encouraged to consider whether the suggested approaches described are relevant to their own circumstances, and if so, to enhance their reporting to meet investor needs more fully.

The Lab considers there to be room for further dialogue and development of enhanced disclosure in this area. Should companies want to build on the existing practices highlighted and explore potential new approaches, the Lab would be pleased to discuss this topic further.

"Our general approach to note disclosure is to ensure the data can be tied back to the financial statements. We feel this helps provide both greater transparency and understanding of our accounting."

Royal Dutch Shell

"We provide a three way reconciliation which links the contractual maturities of our debt to the sterling value of the principal repayments at hedged rates and the carrying values on the balance sheet, thereby tying together all the related debt information."

Tony Chanmugam, BT Group

Lab comment

It can be very important to provide disclosure of basic information on:

- how much debt is owed;
- when it is due to be repaid;
- what is the cost; and
- whether it has been hedged.

These information needs can be met through a combination of disclosures. When deciding the most appropriate disclosures, companies should consider the whole package of detailed and summary level disclosures and whether these questions are answered clearly.

How much is owed?

Disclosure by obligation of:

- principal borrowed;
- currency of denomination; and
- carrying amount on the balance sheet

allows investors to consider underlying currency risk and how closely the carrying amount on the balance sheet approximates the amount to be repaid.

Comparing total principal payments to the carrying amount similarly helps investors assess how close the carrying amount is to the amount to be repaid.

When is it due?

There are two basic approaches to answering this question – in the contractual maturity table, and listing maturity dates by obligation. Investors prefer companies to disclose as a minimum annual maturity amounts for each of the first five years. Tables that aggregate maturities, for example for years two to five, fall well short of this. Disclosing the maturity of each significant obligation gives visibility of the specific maturities.

What is the cost?

Interest rates can be disclosed in detail by obligation and on an aggregate weighted average basis. Investors are interested in the overall profile as well as the rate that will be replaced when an obligation is refinanced at a new rate.

Has it been hedged?

If the currency of the principal or the rate of interest has been hedged, this changes the economic obligation to be met, and the economic cost that will be replaced upon refinancing. Information on how individual obligations or the overall profile are altered can both be helpful in showing the specific impact of derivatives on debt.

Additional suggestions

While answering such questions might be considered fairly basic, some of the additional disclosures suggested by investors go beyond what most companies include in their annual reports. They are included in this report as, if appropriate, companies may wish to consider addressing them in some aspect of their reporting.

Investor observations

Most investors consider detailed data on principal, currency of denomination, maturity year and month, interest rate, prepayment penalties, security, and covenants, as core information to be disclosed.

It was not possible to draw many firm conclusions on the specific needs of different types of investors. However, the use of information is for some more dependent on the general economic and market environment as well as a company's specific situation and any concerns arising.

For example, some investors are less likely to use detailed information on debt terms by obligation for investment grade companies, and more likely to use it during times of financial crisis and where there is a company-specific concern over debt or cash flow generation.

Other investors feel that summarised information, rather than details by individual bond issue, can suffice if supplemented by maturity tables – at least for solidly investment grade companies and in the absence of the pressures of a financial crisis.

Some buy-side investors commented that while they might rarely analyse the detailed disclosure of terms by bond, they feel that the detail is necessary to be disclosed for the sell-side or fixed income and credit analysts. Others indicated that detailed tables can be very useful and are necessary when significant concerns arise, even if only used in detail in more exceptional times.

Investors indicate that some of this detailed information on debt terms is not presented regularly, and sometimes not even presented in circumstances of ongoing stress, when it would be most useful.

Liquidity and funding

Investors made clear that liquidity and funding are no longer taken for granted by either credit or equity analysts. Both funding plans and a company's financial flexibility are considered.

While it is helpful for investors to know if a company is planning to be opportunistic in the bond market, or is not likely to come to market for some time, investors understand the need for companies to remain flexible and not overly commit to a single funding approach. Nonetheless, investors shared a feeling that companies could do a better job of explaining how cash shortfalls and refinancing needs are likely to be met.

Consistency of presentation

Several investors also commented on the importance of consistency of information in tables that are presented and, if necessary, providing notes or descriptions to explain what the amounts represent and how the amounts differ from amounts in other similar tables. For example, many companies provide several debt-related maturity tables, and it can be difficult to detect the nature of any differences between tables.

Labelling information clearly was emphasised, for example making it clear if amounts are shown on the balance sheet directly, or if not, explaining what the amounts do represent and how they differ from the related amounts in the balance sheet and from other tables.

"When debt is very large, changes in interest costs can have a massive impact on free cash flows, and the detail of terms by obligation is needed to evaluate sensitivities."

An equities investor

Terms of obligations – principal, currency, maturity, interest rate

In relation to the principal, currency, maturity, and interest rate of debt obligations, it was noted that the extent of these details disclosed by companies varies, as does the method of presenting such information. This hampers analysis at a common level of detail when investigating particular risks or problems between companies.

Investors generally note that they use detailed information on the basic terms of debt obligations (see Example disclosure 1, Vodafone) to:

- consider the company's sensitivity to various risks, including refinancing risk;
- forecast gross interest costs; and
- help provide a 'sense check' when evaluating the reported interest cost as a percentage of average debt.

Information about fixed or variable interest terms and currency of denomination is helpful to determine specific exposures. Details of fixed and floating rates are useful as well as weighted averages (or ranges of weighted averages).

Such detailed information is also used to understand the specific maturity of an individual debt obligation as this is generally indicative of a refinancing timeline – bringing with it risk as well as a potential investment opportunity – and a change in interest cost.

Company presentation of detailed terms by obligation saves investors asking for this information separately or obtaining it from other sources (if it is available). Some investors regularly summarise this information in a spreadsheet, so providing this level of detail in a note makes the analysis easier and more reliable.

Some investors feel that within detailed lists of the terms of obligations, aggregation of small amounts may be appropriate, as long as it is possible to see the full range of interest rates.

Summary level information on the interest rate and currency profile can be even more useful to some investors than the granular detail from which it can be derived. However, it was highlighted that the maturity profile, instrument types and seniority still need to be made clear within summary information.

Principal and currency of denomination

Disclosing the principal and currency of denomination helps frame the risk of foreign exchange exposure and volatility. In most cases, foreign currency transaction or translation adjustments will mean that the balance sheet amount moves with the spot rate of exchange. This movement may or may not be indicative of the amount to be repaid, depending on hedging activities.

Listing the nominal and carrying amounts by bond is viewed by investors as helpful in showing the underlying position and movements before hedging, as it is the foreign currency obligation that requires repayment or refinancing.

It is also useful to provide information on the amount of consolidated debt resulting from translation of subsidiary debt denominated in a foreign currency, and whether the cash to repay such debt will be financed from the same territory or 'cross-border'.

Information on hedging of foreign currency denominated debt and whether hedge accounting has been applied, is also very valuable to investors. This issue was highlighted in *Lab project report: Net debt reconciliations*.

Maturity dates

Disclosing the month of maturity is important to many investors. Such detail assists in forecasting liquidity requirements and pressure points, and is not normally available from maturity tables. Many investors also believe that this disclosure is not generally a significant burden as they expect companies to have this information readily available.

Explanations of the importance of disclosing the month of maturity include:

- It is the trigger for reclassification into a current liability on the balance sheet. Some investors regularly compare current debt to cash on hand.
- It helps investors estimate the timing of refinancing more precisely. For some, this is important at least for obligations due in the next two years as most companies look to refinance 12-24 months in advance of the contractual maturity.
- Some investors forecast the refinancing outlook by quarter for the next two years, and use this to perform a sense check each quarter to ensure that refinancing requirements have not changed dramatically from previous expectations.

Interest rates

Other investors indicate that, in relatively more complex situations, it is useful to know specifically the interest rate and the period outstanding for obligations to be refinanced, so this can be compared to the current market rate on similar instruments. Based on this, the risk and extent of increased cost can be evaluated.

Some companies have addressed this specific aspect by presenting a weighted average rate, at least for debt issues maturing during the next year or two. Such average coupon rates have been added by BT to their March 2012 disclosure (see Example disclosure 3). Another approach is listing the rate by instrument (see Example disclosure 1).

See additional related points in the Currency and interest profile section.

"Outside periods of stress such as 2007 and 2009, we spend very little time on detailed debt information – but this would be different for sell-side or debt analysts. In periods of stress, information such as maturity and covenants are very important."

An equities investor

Other sources

Investors acknowledge that other sources could potentially be used to obtain certain detailed information on terms, such as subscription-based data providers. Some companies also display more detailed lists of terms on their websites. However, it is viewed as more helpful to be able to see the relevant information in a single document.

If the detailed terms are provided in the annual report, this information will also relate to the same period as the financial statements and the rest of the information presented in that annual report. Information on websites would be expected to be updated periodically, focusing on obligations currently outstanding rather than those related to a set of financial statements. Both are helpful, but in different ways.

Other investors indicate that they want the annual report disclosure to provide detailed information on at least large obligations (i.e. benchmark issues) with a total of listed debt that ties into the balance sheet. While the basic information may already be disclosed in a prospectus, this is often not widely distributed and may be out of date.

Bank facilities

Several investors commented on the need for more complete information on borrowing facilities, suggesting more clarity by facility. This could be presented in a table showing the value drawn in the currency of denomination and the equivalent amount in the company's reporting currency, the undrawn amount available, and the maturity of committed and uncommitted liquidity facilities.

Some of this information may already be given in narrative form. Investors often spend time consolidating such information into a summary table. Company disclosure of a summary table could improve both the efficiency and accuracy of this type of analysis.

Several investors suggested that it would be extremely helpful if the provider of each significant borrowing facility was also disclosed. They note that this information is rarely provided but is important to avoid surprises, for example when a particular provider has already withdrawn facilities from peer companies.

Even those equity analysts that may not regularly pore over details of debt terms by obligation say they need to consider renewals of facilities, and the terms of (or qualification process for) any rollover. For syndicated loans, the nature of the syndicate, such as the number and diversity of banks involved, are important to investors. A concentration of banks from specific country or region, for example, may prove problematic if those banks are under pressure.

"If the terms of bank facilities and the qualification process for any rollover are not disclosed, this is really hiding known potential tipping points."

An equities investor

Covenants and triggers

The loss of debt funding can be a significant risk for holders of the company's equity as well as exposing holders of debt instruments to default risk. As a result, there is significant interest in both the terms and risks associated with covenants and ratings triggers.

Covenant disclosure is particularly important in a climate where ratings downgrades are more prevalent. Investors also indicate that banks are generally taking a harsher view on renewing facilities than before the crisis.

One investor noted the example of an undisclosed credit rating trigger for a borrowing facility which became unavailable when the credit rating tumbled. This illustrates a need for disclosure of whether a covenant or trigger could become material and not just after the event. Materiality needs to be carefully assessed in this regard.

Financial covenants

While many investment grade companies will not have financial covenants, most investors feel that even these companies should disclose that they are not subject to any covenants. The general view is that the absence of financial covenants is just as material as the substance of a covenant when it does apply.

Another investor observed that ideally companies would disclose information on their covenant compliance over the period, including the calculation of how any financial covenants are evaluated. It was also noted that this information is provided to credit rating agencies as a matter of course.

Xchanging discloses its borrowing covenants and current compliance with them in the operating and financial review section of its 2011 Annual Report (see Example disclosure 7).

Ratings triggers

Detail on credit ratings triggers is considered to be important. The example on the right is from BT's most recent annual report, and explains the exposure to changes in interest costs if the rating deteriorates. In addition to this narrative, the company discloses the Moody's and S&P ratings at the balance sheet date, which provides further context.

"Consistent and routine disclosure of information on liquidity and covenants provides investors and other stakeholders with comfort that the business has the funding to achieve its strategy."

David Bauernfeind, Xchanging

"We provide detailed disclosures of the ratings triggers and impact of credit rating changes on our current and future interest expense to allow users to model the impact of different scenarios."

Tony Chanmugam, BT Group

"Covenants should be disclosed: both the terms and risk associated with them. An undrawn borrowing facility may become unavailable due to a ratings trigger – the trigger should be disclosed in order to indicate that a covenant could become material."

An equities analyst

Security and prepayment

Some investors noted that a table showing which obligations are secured and unsecured would save significant investor time in trawling through narrative disclosures for such details. One investor commented that rarely is there no secured debt, but if this is the case, it would also be useful for companies to distinguish their situation by stating this.

Regarding prepayment terms, investors generally do not expect companies to prepay debt significantly in advance of its due date, so this is not a necessary disclosure. However, for very long term debt, it is useful to disclose whether there is anything preventing an early buyback, particularly if the company might have an opportunity to refinance at a lower cost.

Issuer, unguaranteed debt

The identification of the issuing entity, a feature of disclosure by National Grid, is felt to be more relevant to credit analysts. It assists analysts in identifying where debt is located within the Group. This is particularly useful in examining individual operating companies in the Group for cash generated and debt issued. It also assists to establish whether there is any subordination of debt at the parent company level.

BT Group, March 2012 Annual report, page 140, note to table indicating debt terms and carrying amounts of each listed bond and other borrowings:

'The interest rate payable on these bonds will be subject to adjustment from time to time if either Moody's or S&P reduce the rating ascribed to the group's senior unsecured debt below A3 in the case of Moody's or below A- in the case of S&P. In this event, the interest payable on the bonds and the spread applicable to the floating bonds will be increased by 0.25% for each rating category adjustment by each rating agency. In addition, if Moody's or S&P subsequently increase the ratings ascribed to the group's senior unsecured debt, then the interest rate will be decreased by 0.25% for each rating category upgrade by each rating agency, but in no event will the interest rate be reduced below the minimum interest rate reflected in the above table. In July 2011 S&P upgraded BT's credit rating by one category to BBB. At the next coupon date in 2012 the rate payable on these bonds decreased by 0.25 percentage points'

Company organisational charts are also seen as useful in identifying the usual debt issuers within the Group. Investors feel that not many companies provide this information publicly and credit analysts generally rely on representations from companies. However, in complex situations, it is felt that it could be included in annual reports and could even be audited.

Equity analysts do not typically consider the identification of the issuer of the debt to be critical as their focus is on the residual value of the company after net debt. However, restrictions and other limitations on cash transferability are considered to be important if cash will need to be transferred internally in order to meet obligations elsewhere in the group, particularly if this will be done at a cost that would logically be factored into valuation models. Such limits and costs extend beyond the requirements to disclose restrictions under IFRS.

Currency and interest profile, and hedging

Summary tables that show how much of the debt is at fixed versus floating rates, before and after hedging, and the currency of debt and interest both before and after hedging, are very helpful in conveying the contractual and economic profile. Example disclosures 2-4 show different approaches to this.

Interest rate

Investors need to assess whether interest expense and cash costs will change in their forecast horizon. To do this when interest rate and currency is hedged, they look for information relating to the locked-in period and rate, and whether it is high or low relative to the current market rate.

Disclosing weighted average rates on fixed rate borrowings is very helpful; if it is not disclosed, investors often attempt to estimate it as a sense check on interest expense. It also helps investors consider the likely change in interest costs resulting from the refinancing of maturities at current rates. Investors are also interested to see effective coupon rates on floating rate debt.

Many investors indicate that the interest expense reported in the income statement is difficult to understand, as it may be subject to a variety of accounting treatments and is difficult to relate to the underlying debt. One suggestion is to provide a table showing notional borrowing amount, effective interest rate and the related interest cost, and show how this debt interest cost ties into the overall reported interest or financing cost (including capitalised interest and costs of other items such as provisions for asset retirement obligations, pensions, etc.).

Summaries of effective interest rates are also helpful in showing trends in borrowing costs, but the focus of credit analysts is often on the detailed disclosure of terms and maturities by obligation.

Currency

Credit analysts in particular are interested in understanding the hedging of principal. As described in *Lab project report: Net debt reconciliations*, BT's analysis, showing the effect of retranslating the maturity of principal amounts for hedging, is helpful to understanding the specific effect (see Example disclosure 6).

As an indication of maturities, the bar chart disclosed by BT (see Example disclosure 3) helps by showing the original and resulting hedged currency, making clear that there is significant hedging of US Dollar exposure. Knowing both the currency of maturities in need of refinancing and related hedging activities is helpful.

Investors also feel it is useful for companies to show how derivatives (both derivative assets and liabilities) alter the cash profile of the maturity table for debt principal and interest. It is often difficult to see which derivatives relate to debt, and showing their effect on the maturities (both positive and negative) is one way to address this.

"The scope of our debt portfolio necessitates risk associated with interest rates and currencies. Disclosing risk profiles pre and post hedging allows investors visibility into our Treasury risk management and provides greater confidence in predicting our future managed risk profile."

Emmanuel Fraser, National Grid

"We added the average interest rate to our debt maturity chart in our 2012 Annual Report because we wanted to show how future debt repayments are likely to impact our weighted average cost of debt in the coming years."

Tony Chanmugam, BT Group

Balance sheet carrying amount

The carrying value of debt is often used in equity valuation. When subtracting net debt from enterprise value to derive equity value, analysts often start with the reported debt figure on the balance sheet. An estimate of future debt, taking into account refinancing and whether the refinancing will be at a higher cost, may also be used.

The carrying amount of debt on the balance sheet is generally assumed by investors to approximate the principal amount to be repaid or refinanced. While many feel it is useful to know if the carrying value is far from amortized cost or the principal amount to be repaid or refinanced, any difference would have to be quite sizable for investors to make an adjustment in their analysis.

Some investors comment that they are generally unaware of many fair value or other adjustments being made to the carrying value of debt. In part, this may be attributable to the information needed to make such adjustments not being disclosed.

Where there is an array of terms of different obligations, for example issues that are index linked, zero coupon, convertible, etc., it is also helpful to note how different types are accounted for, to the extent it differs for the variety of instruments.

Additionally, investors find it helpful to know which carrying amounts are affected by fair value hedge accounting and fair value accounting, and to disclose the carrying amount of each obligation, as is done by Vodafone (see Example disclosure 1).

Adjustments to debt – fair value hedges

Several investors would like to see disclosure of the linkage between debt obligations and the corresponding amount in the balance sheet, for example disclosure of any fair value hedge accounting adjustments.

Even showing a small overall adjustment provides useful information as it indicates that fair value hedge accounting is currently being applied. It would also be useful for companies to indicate if such adjustments relate to a particular issue of debt, as such an adjustment could be significant to an individual hedged bond, even if less significant to the total amount of debt.

Adjustments to debt – fair value option

Investors generally prefer that companies not apply to debt fair value accounting under the fair value option, though it is acknowledged that this is permitted under IFRS in specific circumstances.

If this accounting method is used, investors are interested in separately seeing the impact of fair value adjustments, bearing in mind that the principal amount borrowed remains the amount that must be repaid.

Adjustments to debt – acquisitions

Regarding the IFRS requirement to adjust to fair value debt that is assumed in an acquisition, many investors are concerned that this moves the reported amount away from approximating the principal due. Interest expense is also affected by this accounting treatment. One commented that the effect of acquisition accounting is not thought to be well understood by investors.

In some cases, if the terms of debt are not disclosed clearly enough to enable an estimate of how different the reported amount of debt is from principal, investors will even go to the effort of obtaining and reviewing the separate financial statements of an acquired subsidiary to see the full information on amounts owed, and the amortized cost value without any fair value acquisition accounting. This is time consuming and could be avoided.

Adjustments to debt – currency movements

It is also important to investors to understand the relationship between currency movements, hedging and whether hedge accounting has been applied or not. An issue for credit metrics and equity valuation is the use of spot rates to arrive at the amount accounted for in the balance sheet. This is not considered helpful when the currency risk of a foreign currency denominated obligation is hedged, because the carrying amount does not represent the likely cash outflow on repayment and may give a 'false' picture of what is economically owed.

Conclusion

Disclosure of the carrying amount of debt obligations is essential information given the variety of accounting methods that may be applied.

The accounting treatment applied could also be indicated in a table listing each obligation so that analysts could more readily identify and understand significant differences between the carrying amounts and principal outstanding (see Example disclosure 1, Vodafone). This approach could also highlight the accounting treatment of convertible debt (when it is issued), as some investors seek to adjust the related debt amount reported, so that it reflects the full principal amount borrowed.

Maturity tables

The majority of investors do analyse maturity tables, and various helpful characteristics of these are described below. A few also commented on the need for maturity tables to be provided as frequently as a company reports (quarterly or half yearly). This is particularly so in conditions of stress, as annual information becomes rapidly out-of-date when there are liquidity pressures.

Some investors, however, indicate that they generally do not use maturity tables, preferring to use a list of obligations and their terms, when this is provided in sufficient detail. A few others obtain more comprehensive information elsewhere – for example credit rating agencies often obtain maturity information privately from companies. Some investors also rely on more detailed liquidity analysis undertaken by sell-side analysts.

Maturity table periods

Several investors indicate that they use maturity information both to evaluate risk to the specific company as well as to compare across companies, and the flexibility of presentation under IFRS hinders comparison.

Generally, investors prefer companies to show maturities at least annually for each of the first five years, followed by an amount 'thereafter'. This standardised minimum level disclosure could be supplemented to provide more detailed information, if preferred by management.

Some also want to see greater granularity in the first year or two, for example quarterly amounts. One investor indicated a preference for annual amounts for the first ten or even 15 years, suggesting that a large maturity will be refinanced two to three years ahead of its contractual maturity date. Visibility of the amounts maturing after five years could be important in considering refinancing activities that will occur within the first five years. This is helpful to fixed income investors as they try to make judgements about when the company will come to market, in order to position their portfolio.

Another suggestion is to show amounts due after the first five years in aggregate five year blocks (i.e. five to ten years, ten to 15 etc.). The segmentation of the funding markets (bank, insurance investment, pension investment etc.) and their respective investment horizons could be an important consideration relative to markets in which such obligations will be refinanced. Disclosing maturities that highlight this profile, for example splitting the amount for five to ten years and a thereafter amount, helps indicate the relative long, medium or short term nature of funding.

Bonds and revolving credit facilities at particularly attractive rates may not be repeated, so investors also need to assess when refinancings will increase borrowing costs. More granularity in maturity tables together with detailed disclosure of terms by facility or instrument, both help to address this point.

"We want annual numbers for first 5 years, as this is compared across companies. This is presented more consistently across European companies. For the amounts after 5 years, it's useful to know if there is a concentration – (is it year 6 or 20?)"

A credit analyst

Maturity of principal and interest

Investors were asked if it is important to show contractual maturities of principal separate from those related to interest. While one observed that it does not matter in judging liquidity whether the payments are for principal or interest, most responses indicate that it is important to split the amounts to enable separate analysis. Investors typically look for the risk of suspending payments of principal, and the step-up of interest costs upon refinancing. Separate disclosure of principal and interest helps with these assessments.

For some investors, the principal amounts are the key focus. It is the liquidity needed to meet principal that may force a company to take action such as selling a division. A principal maturity is also likely to trigger a refinancing event of some magnitude.

Separate disclosure of principal and interest also makes it easier to compare debt repayments across companies and to compare total repayments of principal to the carrying amount of debt on the balance sheet.

Other investors emphasize seeing interest amounts separate from principal, as interest is generally a cash cost, and it is difficult to compare among companies if principal and interest amounts are combined. Interest is also forecasted separately from principal, and when the company's contractual amounts are shown, this is useful as a sense check in comparison to the forecast of interest.

Assumptions made

Investors were asked to comment on the importance of disclosing assumptions made by the company in developing the maturity schedule. Most assume that companies use year-end rates of foreign exchange and interest rates.

Some commented that a standard methodology using year-end exchange and interest rates would provide a consistent starting point from which investors could develop their own view and easily make an adjustment if desired. When investors are working out a problem in analysis, they typically use the rates at the time the analysis is being performed. Consistency of disclosure from companies would facilitate adjustment from a standard assumption. One investor also highlighted

the particular importance of assumptions made for contractual payments related to index-linked debt.

Relating total maturities to the balance sheet

One way in which companies can show the significance of accounting treatments such as fair value or fair value hedge adjustments, acquisition accounting or deferral of issuance costs, is to compare the amount recognised in the balance sheet to the total of contractual obligations to repay the principal. Showing this comparison can provide crucial insight if there is a large difference due to such items.

Investors observe that the comparison also helps tie together amounts and confirms to investors that they are comparing the contractual cash flows to the correct balance sheet debt amounts.

Shell's comparison of amounts, accompanied by an explanation of the difference, is viewed as helpful and sufficient in providing an understanding of what is behind the difference. (See Example disclosure 5).

If the difference was more significant, then a further explanation or reconciliation of the difference would be useful. However some investors feel that, if the differences are not material, comparison may not be very important so long as the description of the borrowings in the maturity table is easy to relate to the amounts on the balance sheet. For example, if the same descriptions and totals or subtotals are used.

Little or no difference provides comfort that the reported amount is a reasonable proxy for principal to be repaid, and disclosure of more significant differences would potentially enable adjustment by investors.

BT's reconciliation of outstanding principal to the balance sheet carrying amount (see Example disclosure 6) highlights the use of fair value hedge accounting. This is useful to consider together with the disclosure of adjustments to retranslate debt principal for currency hedges, which was featured in *Lab project report: Net debt reconciliations*.

BT shows separately the adjustments to the carrying value for fair value hedge accounting and for accrued interest, which is helpful to investors that adjust to remove fair value hedge accounting but leave accrued interest in debt or net debt.

Overall, whether to compare or reconcile amounts depends on whether an issue related to the company's debt, or the size of the difference between contractual and balance sheet amounts, is of importance.

Maturity of the balance sheet carrying amount

Investors were also asked to comment on the usefulness of tables that show the maturity of the balance sheet carrying amount, provided in addition to tables that show contractual maturities.

Most investors consider such disclosures to be unnecessary. It is crucial to understand when a company needs to refresh its debt book and whether it might be at a higher cost, and investors generally look at contractual maturities or the list of debt terms to assess these issues.

There is some interest in looking to the maturity of the balance sheet amount where an investor's model uses balance sheet metrics rather than cash flow metrics (contractual payments). However, comparison or reconciliation of principal maturities to the balance sheet amount would relate these two more directly than is normally the case currently.

Others commented that as long as the difference between contractual payments and the balance sheet carrying amount is not significant, either of the maturity tables gives the basic insight on maturities.

The Lab notes that in theory, the difference in maturity tables represents an allocation to maturity categories in the balance sheet version of various elements of the difference between contractual amounts and the balance sheet carrying amount. Such differences are normally attributable to fair value option or fair value hedge accounting adjustments, acquisition accounting adjustments to fair value, deferred issuance costs, or accrued interest.

"We think it is more useful to analyse contractual payments and to demonstrate how they link with the carrying amount."
Royal Dutch Shell

"Showing a comparison of contractual payments to the carrying amounts can be crucial if there is a large difference due to various accounting adjustments, for interest, acquisition accounting, fair value option or fair value hedge accounting."
A credit analyst

Example disclosure 1

Debt terms

Vodafone, March 2012 Annual Report, page 129

The fair value and carrying value of the Group's long-term borrowings is as follows:

	Sterling equivalent nominal value		Fair value		Carrying value	
	2012 £m	2011 £m	**2012 £m**	2011 £m	**2012 £m**	2011 £m
Financial liabilities measured at amortised cost:						
Bank loans	5,336	5,728	5,625	5,872	5,624	5,873
Redeemable preference shares	1,032	1,027	1,199	1,054	1,281	1,169
Other liabilities	2,325	1,022	2,472	1,023	2,417	1,022
Bonds:	13,184	14,581	14,746	15,578	14,463	16,046
3.625% euro 1,250 million bond due November 2012	–	1,104	–	1,125	–	1,132
6.75% Australian dollar 265 million bond due January 2013	–	171	–	173	–	176
Czech kurona floating rate note due June 2013	18	19	18	19	18	19
Euro floating rate note due September 2013	638	751	641	752	638	752
5.0% US dollar 1,000 million bond due December 2013	625	623	669	676	657	667
6.875% euro 1,000 million bond due December 2013	763	883	834	970	786	922
Euro floating rate note due June 2014	938	1,104	939	1,099	938	1,105
4.15% US dollar 1,250 million bond due June 2014	755	778	808	826	773	802
4.625% sterling 350 million bond due September 2014	304	350	325	367	326	382
4.625% sterling 525 million bond due September 2014	525	525	562	551	541	544
5.125% euro 500 million bond due April 2015	417	442	463	475	442	470
5.0% US dollar 750 million bond due September 2015	469	467	528	506	505	512
3.375% US dollar 500 million bond due November 2015	313	311	335	317	314	312
6.25% euro 1,250 million bond due January 2016	938	1,104	1,094	1,230	953	1,139
2.875% US dollar 600 million bond due March 2016	375	374	393	371	374	371
5.75% US dollar 750 million bond due March 2016	469	467	543	523	522	532
4.75% euro 500 million bond due June 2016	417	442	469	463	455	487
5.625% US dollar 1,300 million bond due February 2017	813	809	954	897	908	920
1.625% US dollar 1,000 million bond due March 2017	625	–	624	–	621	–
5.375% sterling 600 million bond due December 2017	552	600	632	638	573	629
5% euro 750 million bond due June 2018	625	663	726	697	650	689
8.125% sterling 450 million bond due November 2018	450	450	589	550	485	488
4.375% US dollar 500 million bond due March 2021	313	311	348	307	310	309
7.875% US dollar 750 million bond due February 2030	469	467	648	591	751	759
6.25% US dollar 495 million bond due November 2032	310	308	377	332	424	425
6.15% US dollar 1,700 million bond due February 2037	1,063	1,058	1,227	1,123	1,499	1,503
Bonds in fair value hedge relationships:	3,882	3,962	4,541	4,199	4,577	4,265
2.15% Japanese yen 3,000 million bond due April 2015	23	23	24	24	23	23
5.375% US dollar 900 million bond due January 2015	563	560	628	616	621	621
4.625% US dollar 500 million bond due July 2018	313	311	354	327	367	338
5.45% US dollar 1,250 million bond due June 2019	782	778	920	850	898	823
4.65% euro 1,250 million bond January 2022	1,042	1,104	1,203	1,115	1,172	1,114
5.375% euro 500 million bond June 2022	417	442	501	470	532	505
5.625% sterling 250 million bond due December 2025	250	250	294	258	324	284
6.6324% euro 50 million bond due December 2028	42	44	86	68	67	57
5.9% sterling 450 million bond due November 2032	450	450	531	471	573	500
Long-term borrowings	**25,759**	**26,320**	**28,583**	**27,726**	**28,362**	**28,375**

Discloses the corresponding carrying amount on the balance sheet. Also discloses sterling equivalent nominal value, and fair value.

Discloses the terms of each obligation:
- principal
- currency
- interest rate
- maturity month and year

Indicates the accounting method applied.

Shows the total amount on the balance sheet – using the same line item description as is on the balance sheet.

Example disclosure 2

Debt currency and interest rate profile

National Grid, March 2012 Annual Report, page 156 and 157

During 2012 and 2011, derivative financial instruments were used to manage foreign currency risk as follows:

	2012					2011				
	Sterling £m	**Euro £m**	**Dollar £m**	**Other £m**	**Total £m**	Sterling £m	Euro £m	Dollar £m	Other £m	Total £m
Cash and cash equivalents	**14**	**1**	**317**	**–**	**332**	319	1	64	–	384
Financial investments	**1,021**	**84**	**1,200**	**86**	**2,391**	1,046	111	1,696	86	2,939
Borrowings (i)	**(11,034)**	**(4,146)**	**(7,284)**	**(561)**	**(23,025)**	(10,565)	(4,896)	(7,113)	(624)	(23,198)
Pre-derivative position	**(9,999)**	**(4,061)**	**(5,767)**	**(475)**	**(20,302)**	(9,200)	(4,784)	(5,353)	(538)	(19,875)
Derivative effect	**2,584**	**3,845**	**(6,206)**	**482**	**705**	2,921	4,637	(6,962)	548	1,144
Net debt position	**(7,415)**	**(216)**	**(11,973)**	**7**	**(19,597)**	(6,279)	(147)	(12,315)	10	(18,731)

(i) Includes bank overdrafts.

During 2012 and 2011, net debt was managed using derivative instruments to hedge interest rate risk as follows:

	2012					2011				
	Fixed rate £m	**Floating rate £m**	**Inflation linked[i] £m**	**Other[ii] £m**	**Total £m**	Fixed rate £m	Floating rate £m	Inflation linked[i] £m	Other[ii] £m	Total £m
Cash and cash equivalents	**289**	**43**	**–**	**–**	**332**	315	69	–	–	384
Financial investments	**742**	**1,523**	**–**	**126**	**2,391**	759	2,053	–	127	2,939
Borrowings (iii)	**(13,394)**	**(3,314)**	**(6,304)**	**(13)**	**(23,025)**	(13,571)	(3,933)	(5,694)	–	(23,198)
Pre-derivative position	**(12,363)**	**(1,748)**	**(6,304)**	**113**	**(20,302)**	(12,497)	(1,811)	(5,694)	127	(19,875)
Derivative effect (iv)	**1,220**	**(567)**	**52**	**–**	**705**	295	531	318	–	1,144
Net debt position	**(11,143)**	**(2,315)**	**(6,252)**	**113**	**(19,597)**	(12,202)	(1,280)	(5,376)	127	(18,731)

(i) The post-derivative impact represents financial instruments linked to UK RPI.
(ii) Represents financial instruments which are not directly affected by interest rate risk, such as investments in equity or other similar financial instruments.
(iii) Includes bank overdrafts.
(iv) The impact of 2012/13 (2011: 2011/12) maturing short-dated interest rate derivatives is included.

Discloses the currency and interest rate profiles, both before and after hedging.

Example disclosure 3

Debt currency, interest rate, and maturity profile

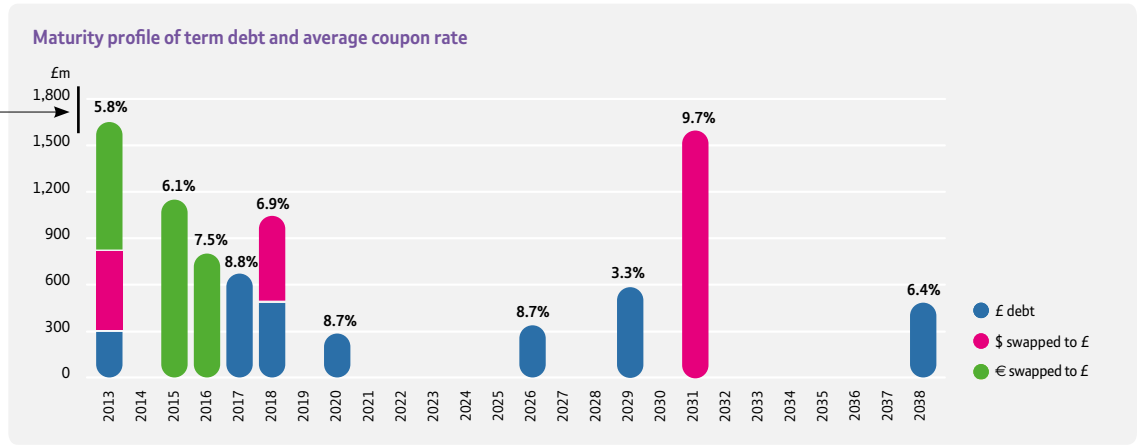
BT Group, March 2012 Annual Report, page 55; March 2011 Annual Report, page 53

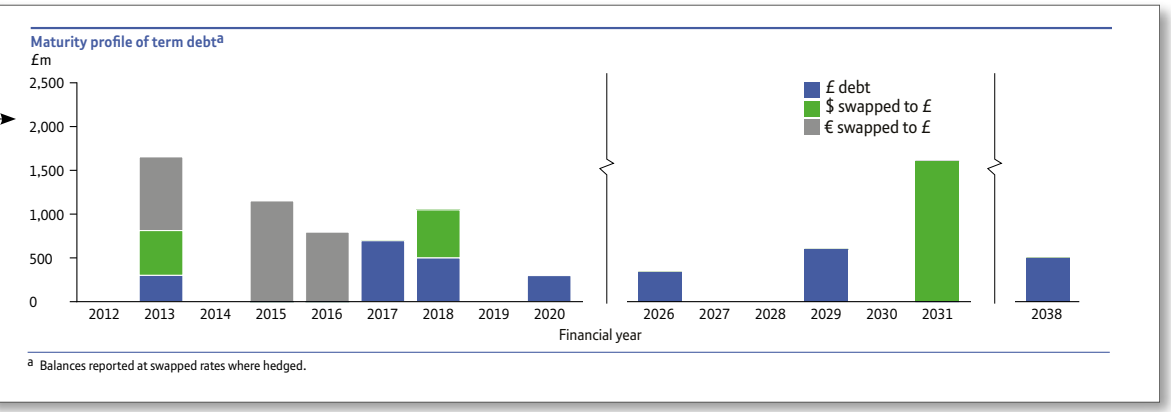
BT added disclosure of the average coupon rate in the 2012 disclosure.

The 2011 disclosure supplements a maturity profile with information on the extent to which debt was swapped to £ from other currencies.

Debt maturity analysis

The maturity profile of our term debt and average coupon rate is shown in the graph below. Out of total gross debt of £9.9bn, £1.7bn of term debt is repayable in 2013.





Charts indicate both the original currency profile and the profile after hedging.

(Example disclosure 3 – continued)

Debt currency and interest rate profile

BT Group, March 2012 Annual Report, page 141

As noted above, the principal repayments of loans and borrowings at hedged rates amounted to £9,925m (2011: £9,187m). The table below reflects the currency risk and interest cash flow and fair value risk associated with these loans and borrowings after the impact of hedging.

	2012			2011		
At 31 March	Fixed rate interest £m	Floating rate interest £m	Total £m	Fixed rate interest £m	Floating rate interest £m	Total £m
Sterling	7,948	1,522	9,470	7,954	913	8,867
Euro	–	447	447	–	283	283
US Dollar	6	1	7	18	2	20
Other	–	1	1	–	17	17
Total	**7,954**	**1,971**	**9,925**	**7,972**	**1,215**	**9,187**
Weighted average effective fixed interest rate						
Sterling	7.3%			7.4%		

The floating rate loans and borrowings bear interest rates fixed in advance for periods ranging from one day to one year, primarily by reference to LIBOR and EURIBOR quoted rates.

Table indicates the fixed and floating interest rate profile, after hedging.

Discloses weighted average interest rates.

Example disclosure 4

Debt currency and interest rate profile

Vodafone, March 2012 Annual Report, Page 131

Table shows a matrix of both the interest rate and currency of borrowings, after hedges.

Interest rate and currency of borrowings

Currency	Total borrowings £m	Floating rate borrowings £m	Fixed rate borrowings[1] £m	Other borrowings[2] £m
Sterling	2,838	912	1,926	–
Euro	10,696	4,408	6,288	–
US dollar	14,085	4,521	9,495	69
Japanese yen	23	23	–	–
Other	6,978	3,489	2,718	771
31 March 2012	**34,620**	**13,353**	**20,427**	**840**
Sterling	2,831	906	1,925	–
Euro	12,361	4,198	8,163	–
US dollar	16,030	9,488	3,352	3,190
Japanese yen	807	807	–	–
Other	6,252	2,920	3,332	–
31 March 2011	**38,281**	**18,319**	**16,772**	**3,190**

Notes:

1 The weighted average interest rate for the Group's sterling denominated fixed rate borrowings is 5.7% (2011: 5.7%). The weighted average time for which these rates are fixed is 4.5 years (2011: 5.4 years). The weighted average interest rate for the Group's euro denominated fixed rate borrowings is 4.2% (2011: 4.3%). The weighted average time for which the rates are fixed is 2.8 years (2011: 3.8 years). The weighted average interest rate for the Group's US dollar denominated fixed rate borrowings is 5.1% (2011: 5.4%). The weighted average time for which the rates are fixed is 10.0 years (2011: 9.7 years). The weighted average interest rate for the Group's other currency fixed rate borrowings is 10.1% (2011: 9.2%). The weighted average time for which the rates are fixed is 2.7 years (2011: 2.0 years).

2 Other borrowings of £840 million (2011: £3,190 million) are the liabilities arising under options over direct and indirect interests in Vodafone India.

The figures shown in the tables above take into account interest rate swaps used to manage the interest rate profile of financial liabilities. Interest on floating rate borrowings is generally based on national LIBOR equivalents or government bond rates in the relevant currencies.

Shows weighted average interest rates for fixed rate borrowings, by currency.

Such information could alternatively be presented in a table.

Example disclosure 5

Contractual obligations maturity table

Royal Dutch Shell, 2011 Annual Report, page 123

Discloses maturity amounts annually for each of years 1-5.

The following tables compare contractual cash flows for debt (excluding finance lease obligations) owed at December 31, with the carrying amount in the Consolidated Balance Sheet. Contractual amounts reflect the effects of changes in currency exchange rates; differences from carrying amounts reflect the effects of discounting, premiums and, where hedge accounting is applied, fair value adjustments. Interest is estimated assuming interest rates applicable to variable rate debt remain constant and there is no change in aggregate principal amounts of debt other than repayment at scheduled maturity as reflected in the table.

Explains the nature of the difference between total contractual payments and the balance sheet carrying amount.

2011 $ MILLION

	Contractual payments								
	Less than 1 year	Between 1 and 2 years	Between 2 and 3 years	Between 3 and 4 years	Between 4 and 5 years	5 years and later	Total	Difference from carrying amount	Carrying amount
EMTN programme	2,262	3,231	–	–	1,615	5,169	12,277	608	12,885
US shelf registration	1,500	2,000	2,500	2,750	–	7,750	16,500	342	16,842
Bank borrowings and other	2,640	2	1	58	387	37	3,125	–	3,125
Total (excluding interest)	6,402	5,233	2,501	2,808	2,002	12,956	31,902	950	32,852
Interest	1,308	1,037	866	789	729	6,009	10,738		

Discloses principal and interest amounts separately, so principal can be compared to the balance sheet carrying amount.

Compares total of contractual amounts to the carrying amount on the balance sheet.

2010 $ MILLION

	Contractual payments								
	Less than 1 year	Between 1 and 2 years	Between 2 and 3 years	Between 3 and 4 years	Between 4 and 5 years	5 years and later	Total	Difference from carrying amount	Carrying amount
CP programmes	3,931	–	–	–	–	–	3,931	–	3,931
EMTN programme	320	2,335	3,335	–	–	7,004	12,994	262	13,256
US shelf registration	3,000	1,500	2,000	2,500	2,750	7,750	19,500	253	19,753
Bank borrowings and other	2,404	32	86	3	169	163	2,857	–	2,857
Total (excluding interest)	9,655	3,867	5,421	2,503	2,919	14,917	39,282	515	39,797
Interest	1,310	1,155	1,040	868	791	6,729	11,893		

Example disclosure 6

Maturity of principal

BT Group, March 2012 Annual Report, pages 141 and 149

Reconciles contractual maturities of principal and accrued interest, to the carrying amount on the balance sheet. Shows the fair value hedge adjustment to debt.

At 31 March	2012 Carrying amount £m	2012 Effect of hedging and interest[a] £m	2012 Principal repayments at hedged rates £m	2011 Carrying amount £m	2011 Effect of hedging and interest[a] £m	2011 Principal repayments at hedged rates £m
Repayments fall due as follows:						
Within one year, or on demand	**2,887**	**(262)**	**2,625**	**485**	**(266)**	**219**
Between one and two years	10	–	10	1,747	(66)	1,681
Between two and three years	1,132	26	1,158	10	–	10
Between three and four years	845	(40)	805	1,209	(48)	1,161
Between four and five years	695	–	695	901	(94)	807
After five years	4,839	(207)	4,632	5,507	(198)	5,309
Total due for repayment after more than one year	**7,521**	**(221)**	**7,300**	**9,374**	**(406)**	**8,968**
Total repayments	**10,408**	**(483)**	**9,925**	**9,859**	**(672)**	**9,187**
Fair value adjustments for hedged risk	78			(3)		
Total loans and other borrowings	**10,486**			**9,856**		

[a] Adjustments for hedging and interest reflect the impact of the currency element of derivatives and adjust the repayments to exclude interest recognised in the carrying amount.

Shows the profile before and after currency hedges.

Shows adjustment to remove accrued interest and retranslate the principal maturities of debt at hedged rates to derive the maturity of principal amounts at hedged rates.

Alternatively, the payment of accrued interest (of £255m) could be excluded from the repayment amounts and shown as an adjustment between total repayments of principal and the balance sheet carrying amount. This is the approach taken in the contractual maturities table.

Non-derivative financial liabilities At 31 March 2012	Loans and other borrowings £m
Due within one year	2,632
Between one and two years	10
Between two and three years	1,132
Between three and four years	845
Between four and five years	695
After five years	4,839
	10,153
Effect of interest	255
Fair value adjustment for hedged risk	78
Total[a]	**10,486**

[a] Foreign currency related cash flows were translated at closing rates as at the relevant reporting date.

Reconciles contractual payments of principal to the carrying amount of debt on the balance sheet.

Shows separate adjustments for interest accruals and fair value hedge accounting adjustments. Some investors adjust for one or both of these. Disclosing the interest accrual also confirms that interest is included in the reported amount of debt.

Shows total of the balance sheet carrying amount.

Example disclosure 7

Covenant disclosures

Xchanging, 2011 Annual Report , page 39

Borrowing covenants
The Group is subject to covenants, representations and warranties commonly associated with corporate bank debt for its term loan and revolving credit facilities.

As at 31 December 2011, there were financial covenants associated with the committed debt facilities relating to leverage, interest cover and debt service. The Group was compliant with all three covenants:

- the ratio of consolidated borrowings to Xchanging's share of consolidated profit before depreciation and amortisation (pre-exceptional items) must not exceed 2.0 times. As at 31 December 2011, the ratio was 1.1 times;
- the ratio of Xchanging's share of consolidated profit before depreciation and amortisation (pre-exceptional items) to net consolidated finance charges must not be less than 6.0 times. As at 31 December 2011, the ratio was 18.4 times; and
- the ratio of net cash flow to UK cash pool debt service must not be less than 1.0 times. As at 31 December 2011, the ratio was 3.0 times.

Discloses the existence of financial covenants, compliance with them, and headroom.

Project methodology

The overall objective of this project was to explore various voluntary practices and to identify those that investors found to be useful to their analysis, indicating why this is the case and how information is used. Companies are encouraged to consider whether the potential reporting changes arising from this are material and of relevance in the context of the company's own financial reporting.

The Lab has not mapped the comments made by investors against specific reporting requirements as this report is not a technical report, rather one that largely reflects the comments and perceptions of investors. Some aspects of corporate reporting that are mentioned by investors as being useful may already be required.

It is the responsibility of each reporting company to ensure compliance with relevant reporting requirements, including requirements that the accounts give a true and fair view.

Company participation

Five companies volunteered to participate in this project to have the Lab facilitate feedback from investors on the usefulness of specific characteristics of the companies' existing published disclosure on debt and cash flows.

The five companies are:

- BT Group
- National Grid
- Royal Dutch Shell
- Vodafone
- Xchanging

The Lab worked with these companies to develop a list of questions to be discussed with investors, and identify excerpts from their accounts to be provided alongside the questions to help illustrate the various points raised. The section of this report on 'Investor observations' reflects the questions raised for discussion with investors.

Investment community participation

The most significant portion of the project research was gathered during a series of mainly face-to-face discussions with members of the investment community, taking place from February to June 2012. Discussions lasted on average just over an hour. Investors were asked to comment on the importance of disclosure on debt and cash flows, and their use of specific information based on the series of questions developed and the examples from disclosure of the five participating companies.

The following organisations contributed views from the investment community in their capacity as investors or other analyst organisations that work in the interest of investors:

- Allianz Global Investors
- Blackrock Investment Management
- CFA Institute
- CFA Society of the UK
- CreditSights
- Deutsche Bank
- Fidelity Management and Research
- Fidelity Worldwide Investments
- Fitch Ratings
- Goldman Sachs Asset Management
- Henderson Global Investors
- Institutional Investment Advisors
- JP Morgan
- Moody's Investors Service
- ShareSoc
- UBS

These 16 organisations cover a wide spectrum of use of reported information by institutional and retail investors, broker sell-side and independent research organisations, credit rating agencies, analyst associations and other advisers. A total of 19 meetings were held and one written submission was received.

In all, views were obtained from over 30 individuals, and these were split relatively evenly between individuals having an equities and fixed income or credit focus. Most participants follow companies or manage funds directly, and these were complemented by a few accounting specialists. While approximately half of the investors that provided input to the project commented from the perspective of following one or more of the five participating companies, others commented more generally from the perspective of corporate equity and fixed income or credit analysis.

In this project, the Lab did not attempt to navigate to an agreed answer on each question or point discussed, nor was there an attempt to strive for consensus among investors, or between investors and companies. The meetings were more discussion-based, spending more time on aspects that participants showed a relatively greater interest in, to understand better whether and how various characteristics of information are used by individual investors.

The objective of these discussions was to reflect on the various considerations noted by investors as being important relative to their analysis of debt and cash flows, and obtain explanations where possible of how information is used, so that this could be reported on by the Lab.

This report shares the insights gained from the investor meetings and the additional written input received. It is hoped that companies will consider whether the suggested approaches described are relevant to their own circumstances.

The Lab's testing of investor input used the December 2010/March 2011 disclosures of the five companies as illustrative. However, this report also includes the updated December 2011/March 2012 disclosures as being equally illustrative of the points highlighted.

Project context: focusing on what is important

Recent FRC guidance published in *Cutting clutter: Combating clutter in annual reports (2011)* and *Financial Reporting Review Panel: Annual Report 2011* and *Financial Reporting Review Panel: Annual Report 2012* has encouraged all those involved in preparing financial reports to exercise judgement to determine and apply a quantitative threshold and qualitative assessment for materiality in relation to disclosures.

A more rigorous approach to materiality judgements might result in financial reports that are more meaningful, focused and relevant to investors because inconsistencies and superfluous material will have been avoided. Clutter undermines the usefulness of annual reports and accounts by obscuring important information and inhibiting a clear understanding of the business and the issues it faces.

In July 2012, the FRC, in partnership with the European Financial Reporting Advisory Group (EFRAG) and the Autorité des Normes Comptables (ANC), published a Discussion Paper *Towards a Disclosure Framework for the Notes*. That paper forms an essential part of the full disclosure picture but is deliberately limited in scope. The FRC continues to consider how a disclosure framework might contribute to improvements in corporate reporting, and has recently published a Discussion Paper *Thinking about disclosures in a broader context* which considers disclosures more holistically.

Other reports published by the Lab recently:

November 2012: *Operating and investing cash flows*

September 2012: *Net debt reconciliations*

June 2012: *A single figure for remuneration*

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