

STAFF PAPER

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Accounting Standards Advisory Forum

Project	Primary Financial Statements		
Paper topic	Feedback on the UK FRC Discussion Paper		
CONTACT(S)	Michelle Fisher Karlien Conings	mfisher@ifrs.org kconings@ifrs.org	+44(0) 20 7246 6918 +44(0) 20 7246 6913

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1. The UK Financial Reporting Council (FRC) published a Discussion Paper¹ *Improving the Statement of Cash Flows* (the FRC Discussion Paper) in October 2016. The FRC Discussion Paper aimed to stimulate debate that would be of interest to the International Accounting Standards Board (Board). It set out a number of suggestions—which do not represent official positions of the FRC—for changes to the current requirements of IAS 7 *Statement of Cash Flows*. In July 2017, the FRC published a Feedback Statement that provides an overview of the responses. The Discussion Paper provided a rationale for its suggestions. The Feedback Statement necessarily places more emphasis on the points made by respondents that disagreed than those that agreed.
2. The purpose of this ASAF discussion is to elicit members' views on the implications of the FRC Discussion Paper (including the responses) for the Board's project on Primary Financial Statements. We are not asking ASAF members views on particular ideas, but rather if members think some of the suggestions should be considered in the Board's Primary Financial Statements project.

¹ The Discussion Paper, the responses and the Feedback Statement may be accessed at:
<https://www.frc.org.uk/consultation-list/2016/discussion-paper-improving-the-statement-of-cash>

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3. The papers for this session, in addition to this paper are:
- (a) Agenda Paper 2A (slide presentation): provides a high-level overview of the feedback received on the FRC Discussion Paper;
 - (b) Agenda Paper 2B: the FRC's Feedback Statement; and
 - (c) Agenda Paper 2C: outlines the IASB staff's plans for considering the FRC Discussion Paper (including the responses) and provides an initial IASB staff analysis of how the main suggestions in the FRC Discussion Paper might be dealt with in the Primary Financial Statements project.
4. In July 2016, ASAF members discussed a draft of the FRC Discussion Paper. A summary of this discussion is included in the appendix to this paper.

Questions for ASAF members on papers 2A-2C

1. What, in your view, are the implications of the FRC Discussion Paper (including the responses) for the Board's project on Primary Financial Statements?
2. Do ASAF members have any questions or comments about the IASB staff's plans for considering the feedback on the FRC Discussion Paper (see Agenda Paper 2C, paragraphs 7-8) and the analysis in the appendix to Agenda Paper 2C?

Appendix—Extract of the summary of the ASAF meeting on Primary Financial Statements (July 2016)—Improving the statement of cash flows

A1. This session sought the views of ASAF members on a number of suggestions to improve the statement of cash flows. Those suggestions are included in a draft Discussion Paper (DP) prepared by the staff of the UK Financial Reporting Council (FRC); Agenda Paper 4A for the July 2016 ASAF meeting. ASAF members were asked to express any concerns regarding the clarity and the completeness of the draft DP.

The objective of the statement of cash flows

- A2. The draft DP suggests amending the objective of the statement of cash flows to ‘assisting an assessment of the entity’s liquidity and changes in that liquidity’.
- A3. Some ASAF members did not support this suggestion. One member commented that a disclosure that has the primary purpose of assisting a liquidity assessment should not resemble the statement of cash flows. In this member’s view, such a disclosure should combine information about past cash flows with forward-looking information, including a maturity analysis as currently required by IFRS 7 *Financial Instruments: Disclosures* and other factors. Another member agreed that a liquidity assessment requires forward-looking information.

The classification of cash flows

- A4. ASAF members had mixed views about the suggestion to define cash flows from operating activities positively, rather than as a default category. An ASAF member stated that defining cash flows from operating activities positively would create a new residual category, which might be misused as a location for presenting some negative cash flows.
- A5. One ASAF member did not agree with the suggestion included in the draft DP to report cash outflows to acquire property, plant and equipment within operating activities rather than within investing activities. That member questioned whether it would be appropriate to present cash flows related to assets acquired in a business combination differently from other asset acquisitions.

- A6. Another ASAF member commented that the draft DP was not clear on whether the proposal would also apply to disposals of property, plant and equipment and whether cash flows resulting from the disposal of investment properties should be treated in the same way as the cash flows from the disposal of property, plant and equipment and intangibles. This member also suggested that the paper should clearly state how cash flows for lease payments should be presented in the statement of cash flows, when applying IFRS 16 *Leases*.
- A7. One member noted support from users in their jurisdiction for the suggestion in the draft DP to eliminate the options currently available for the classification of interest and dividend cash flows in the statement of cash flows.

Cash equivalents and the management of liquid resources

- A8. The draft DP suggests that the statement of cash flows should report inflows and outflows of cash, rather than cash and cash equivalents, and that a separate section of the statement of cash flows should report cash flows relating to the management of liquid resources. Liquid resources should be limited to assets that are readily convertible into cash, but should otherwise not be restrictively defined.
- A9. ASAF members reported mixed views on this suggestion. Some argued that analysts prefer to construct an adjusted statement of cash flows themselves, taking into account their personal view on liquidity. Consequently, analysts do not support replacing the statement of cash flows by a statement of changes in liquidity.
- A10. One ASAF member asked the staff to clarify the relationship between cash equivalents and liquid resources.
- A11. Several ASAF members also commented that the current definition of cash and cash equivalents is not clear.
- A12. Some ASAF members stated that a focus on cash was unhelpful without considering how restricted cash balances would be dealt with.

Reconciliation of operating activities

- A13. The draft DP suggests introducing a requirement to reconcile a subtotal in the statement of profit or loss that represents operating profit or loss to cash flow from operating activities. The draft DP argues that this reconciliation should be provided in the notes, as the reconciliation does not report cash flows and does not relate to the primary purpose of the statement of cash flows.
- A14. One member supported the suggestion to include this reconciliation in the notes to the cash flow statement. This member added that using operating profit as the starting point for the reconciliation would be challenging, though, as it is neither defined nor required by IFRS Standards.
- A15. Another ASAF member said the reconciliation should be included in the statement of cash flows instead, as this option was preferred by investors in the work undertaken by the FRC's Financial Reporting Lab.

Direct or indirect method

- A16. The draft DP suggests that the direct method cash flow statement should be neither required nor prohibited. It argues that a better focus is to consider what specific disclosures should be required. One ASAF member stated that new empirical evidence supports the importance of the direct method for predicting future cash flows.

General Comments

- A17. ASAF members made the following general comments:
- (a) a major overhaul of the statement of cash flows should not be a priority. If the Board decides to amend the requirements for the statement of cash flows, it should do so in the context of a complete set of financial statements and not in isolation.
 - (b) the DP should include a feedback summary explaining the work that has been done in the past, including the 2010 IASB staff draft developed in the Financial Statement Presentation project.

- (c) there is a view that management are generally too focused on cash flows when explaining their business activities. To counter this view, managers should be reminded why the accrual basis of accounting is important.
- (d) there should be a dialogue between the FRC and the IASB staff on this topic. The IASB staff and FRC staff confirmed that there is regular dialogue.