

STAFF PAPER

September 2017

Accounting Standards Advisory Forum

| Project | Primary Financial Statements | | |
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| Paper topic | FRC Discussion Paper <i>Improving the Statement of Cash Flows—Implications for the Primary Financial Statements</i> project | | |
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This paper has been prepared for discussion at a public meeting of the Accounting Standards Advisory Forum. The views expressed in this paper do not represent the views of the International Accounting Standards Board (Board) or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® *Update*.

Purpose of paper

1. The purpose of this paper is to:
 - (a) outline the IASB staff's plans for considering the feedback on the UK Financial Reporting Council (FRC) Discussion Paper *Improving the Statement of Cash Flows* (the FRC Discussion Paper); and
 - (b) provide 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.

Background

2. At the December 2016 Board meeting, the Board tentatively decided that on the basis of the feedback received from our international outreach and research (presented at the November 2016 Board meeting), the Primary Financial Statements project should focus on targeted improvements to the statement(s) of financial performance and the statement of cash flows. Such targeted improvements could address the main areas of concern identified and be completed relatively quickly.

3. The IASB staff sought the view of the Accounting Standards Advisory Forum (ASAF) about the scope of the project during the July 2016 and March 2017 meetings and the ASAF was generally supportive of our proposals.
4. Our main focus is the statement(s) of financial performance because this is where we have heard there is the greatest need for improvement. However, we also expect to consider some improvements to the statement of cash flows to eliminate some diversity in practice and achieve consistency with the statement(s) of financial performance.
5. For the statement of cash flows, the Board tentatively decided that as part of the project scope we should explore whether to make improvements in the following areas:
 - (a) eliminating options for the classification of interest and dividends in the statement of cash flows;
 - (b) aligning the operating section across the statement(s) of financial performance and the statement of cash flows (ie consistency between an entity's operating profit¹, if presented, and its cash flows from operating activities); and
 - (c) requiring a consistent starting point for the indirect reconciliation of cash flows.
6. The IASB staff identified these three possible areas for improvements through our research and outreach on the scope of the Primary Financial Statement project².

¹ The IASB staff are developing proposals for requiring additional subtotals in the statement(s) of financial performance. However, the Board has been focussing on defining EBIT, rather than operating profit.

² See November 2016 Board meeting, [Agenda Paper 21A](#) (paragraphs 51-62), [Agenda Paper 21C](#) and [Agenda Paper 21D](#) (paragraphs 30-32) and December 2016 Board meeting, [Agenda Paper 21B](#) (paragraphs 8-26).

Planned next steps

7. The IASB staff intends to bring detailed proposals on the areas listed in paragraph 5 to the Board in the following months, after the Board has discussed the main IASB staff proposals related to the statement(s) of financial performance. When developing proposals for the areas in paragraph 5, the IASB staff will consider the relevant feedback received on the FRC Discussion Paper.
8. The IASB staff will also consider the FRC staff's other suggestions and related feedback, and develop proposals for the Board on which other areas we might explore further. In those cases, further research and outreach may be required to determine the costs and benefits of the FRC staff's suggestions. However, the IASB staff is unlikely to propose that we explore all of the changes suggested in the FRC Discussion Paper because our intention in this project is to focus on targeted improvements to the statement of cash flows that were suggested by our research and outreach. Nevertheless, where the FRC staff has suggested more significant changes to the statement of cash flows, such suggestions could be considered when determining the Board's future research projects.

Initial IASB staff analysis of possible implications for the Primary Financial Statements project

9. The table in the appendix to this paper includes the IASB staff's initial assessment of how the main suggestions in the FRC Discussion Paper might be dealt with in the Primary Financial Statements project. This analysis has not been discussed with the Board yet.

Appendix— Initial IASB staff analysis of possible implications for the Primary Financial Statements project

| DP Ques- -tion | Main suggestions in the FRC Discussion Paper on which feedback was specifically invited | Main messages from respondents | Related to proposed scope of IASB project? | Initial IASB staff analysis of possible implications for the Primary Financial Statements project |
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| Section 1—The usefulness of information about cash flows | | | | |
| 1 | The main objective of cash flow information is to assist users to assess liquidity, and the financial structure of the entity and changes in it. | Some agree | No | Reviewing the objective of the statement of cash flows in IAS 7 <i>Statement of Cash Flows</i> is beyond the scope of the Primary Financial Statements project. |
| 2 | Notional cash flows should not be reported in the statement of cash flows, but non-cash transactions should be transparently disclosed. | Large majority agree | No | The feedback received by the FRC generally supports the current requirements in IAS 7, paragraphs 43-44, covering non-cash investing and financing transactions. |
| Section 2—The classification of cash flows | | | | |
| 3 | Operating activities should be positively defined or described rather than being a residual or default classification. | Majority agree | No | The Board has tried to positively define and/or describe ‘operating activities’ and ‘operating profit’ in the past without success. For this reason, the Board has been focussing on defining EBIT, rather than an operating profit subtotal. During outreach, we received support for this approach (eg in the July 2016 ASAF meeting). |

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| | | | | <p>However, positively defining ‘operating activities’ is something we could seek feedback on in our first due process document.</p> <p>At the September 2017 Board meeting the Board will be discussing an IASB staff proposal to define financing income/expenses and investing income/expenses, which would be presented in the statement(s) of financial performance. This would in effect be creating an operating category in the statement of financial performance as a residual category.</p> |
| | The same notion of operating activities should be used for both the statement of cash flows and the statement(s) of financial performance. | Almost half of respondents agree | Yes, para. 5(b) | At the December 2016 Board meeting, the Board tentatively decided to explore aligning the operating sections of the statement(s) of financial performance and the statement of cash flows. |
| 4 | Cash outflows to acquire property, plant and equipment should be reported as a cash outflow from operating activities, with a subtotal drawn before capital expenditure. | Split views | Yes, para. 5(b) | The Board could consider classifying cash outflows to acquire property, plant and equipment as ‘operating activities’ to achieve closer alignment with the classification in statement(s) of financial performance, as income and expenses on property, plant and equipment are usually included in operating profit (or similar subtotals such as EBIT), if presented. |
| | Entities should be encouraged to disclose the extent to which expenditure on property, plant and equipment represents ‘replacement’ or ‘expansion’. | Some support encouraging such disclosures. Majority say such disclosures should not be required. | No | The feedback received by the FRC supports the encouraged disclosures in IAS 7 paragraphs 50(c) and 51. We do not think these requirements need further clarification. |

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| 5 | Cash flows on financing liabilities (including the payment of interest) should be reported in the financing category of the cash flow statement. | Majority agree | Yes, para. 5(a) | At the December 2016 Board meeting, the Board decided to explore eliminating the classification options for interest and dividends in the statement of cash flows. |
| 6 | Cash flows relating to tax should be reported in a separate section. | Majority agree | Partially, para. 5(b) | The Board could consider if introducing a separate section for cash flows arising from taxes at the end of the statement of cash flows provides better information. This might also result in closer alignment between the way tax is presented in the statement of cash flows and statement(s) of financial performance. |
| Section 3—Cash equivalents and the management of liquid resources | | | | |
| 7 | The statement of cash flows should report inflows and outflows of cash, rather than cash and cash equivalents. 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 readily convertible into cash, but should otherwise not be restrictively defined. | Split views | No | Our research and outreach on the scope of the project did not identify this as an area in need of improvement. We do not think that the feedback received by the FRC has highlighted this as something we should consider. |
| 8 | Net presentation of cash flows (other than those in respect of operating activities) should be permitted only for cash flows relating to financial instruments that are of the same class. | Some agree | No | The Board could consider refining the requirements in IAS 7, paragraph 22, about reporting cash flows on a net basis. |

| Section 4—Reconciliation of operating activities | | | | |
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| 9 | A reconciliation between a subtotal in the statement of profit or loss that represents operating income and cash flows from operating activities should be presented in all cases, including when a direct method cash flow statement is presented. | Majority agree | Yes, para. 5(b)-(c) | At the December 2016 Board meeting, the Board tentatively decided to explore requiring a consistent starting point for the indirect reconciliation of cash flows. In Agenda Paper 21B for that meeting, the IASB staff provided some benefits of having a comparable subtotal such as EBIT as the starting point. This approach is also generally supported by the feedback received by the FRC. However, such an approach may depend on the Board successfully defining an appropriate subtotal as a starting point. |
| | Such a reconciliation should be presented as a note, rather than in the statement of cash flows. | Variety of views | | The Board could consider requiring such a reconciliation in all cases, including when a direct method cash flow statement is presented. The Board could consider requiring the presentation of this reconciliation as a note. |

| Section 5—Direct or indirect method | | | | |
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| 10 | The direct method statement of cash flows should neither be prohibited nor required. | Large majority agree | No | The feedback received by the FRC supports the current requirements in IAS 7, paragraph 18, which allow, rather than require the direct method. We do not think these requirements need further clarification. |
| 11 | An accounting standard should identify components of cash flow from operating activities that are particularly significant, and require disclosure either of the amount of such components or of changes in related working capital items. | Variety of views | No | At the December 2016 Board meeting, the Board tentatively decided to explore improving disaggregation in the primary financial statements, which may include disaggregation of changes in working capital ³ . |

³ See December 2016 Board meeting, [Agenda Paper 21B](#) (paragraphs 45-46).