STAFF PAPER

February 2018

IASB Meeting

Project	**Primary Financial Statements**
Paper topic	Presentation of the cash flows of 'integral' and 'non-integral' associates and joint ventures

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Purpose of the paper

1. This paper:

   (a) addresses the classification in IAS 7 *Statement of Cash Flows* of the cash flows that arise between an entity (acting as an investor) and its investments in associates or joint ventures (ie its 'investees'); and

   (b) explores whether the Board should require separate presentation of the 'investing' cash flows of 'integral' and 'non-integral' associates and joint ventures in the statement of cash flows.

2. This paper does not address the cash flows that arise between a financial institution (and other entities providing financing services) and its associates and joint ventures. We would like the Board to focus on determining a suitable approach for a straightforward non-financial entity first. We will consider at a future meeting how this approach could be applied or adapted to more complex scenarios.

Structure of paper

3. The paper is structured as follows:

   (a) Summary of staff recommendations (paragraph 4);

(b) Staff analysis (paragraphs 5–37); and

(c) Appendix A — Previous Board discussions

(i) Summary of discussions on the classification of dividends received and on the starting point for the indirect reconciliation of cash flows in the statement of cash flows; and

(ii) Summary of discussions on the classification of the share of the profit or loss of associates and joint ventures in the statement(s) of financial performance.

(d) Appendix B — Presentation alternatives for ‘integral’ associates and joint ventures.

Summary of staff recommendations in this paper

4. The staff recommends that the Board requires:

(a) separate presentation of the cash flows that arise between an entity and its ‘integral’ associates and joint ventures from the cash flows that arise between an entity and its ‘non-integral’ associates and joint ventures;

(b) that the split between ‘integral’ and ‘non-integral’ associates and joint ventures be the same for the statement of cash flows as for the statement(s) of financial performance; and

(c) separate presentation of ‘integral’ and ‘non-integral’ associates and joint ventures in the ‘investing activities’ section of the statement of cash flows (ie Approach B, discussed as part of Issue 3).

Staff analysis

5. We have split our analysis into the following topics:

(a) <u>Issue 1.</u> What are the cash flows that can arise between an entity and its associates and joint ventures? (paragraphs 6–12)

(b) Issue 2. Should the Board consider presenting the 'investing' cash flows of 'integral' and 'non-integral' associates and joint ventures separately? (paragraphs 13–18)

(c) Issue 3. How should the cash flows of 'integral' associates or joint ventures be presented? (paragraphs 19–37)

Issue 1. What are the cash flows that can arise between an entity and its associates and joint ventures?

6. Paragraphs 37–38 of IAS 7 require an entity investing in an associate or a joint venture accounted for using the equity method, to restrict its reporting in the statement of cash flows to the cash flows between the entity and its investments in associates or joint ventures. These paragraphs provide a few examples of cash flows that may arise between the entity and its investments in associates or joint ventures, but do not provide classification guidance for those cash flows. These examples are: 'dividends and advances' or 'distributions and other payments or receipts'.

7. Paragraph 16(c)–(f) and paragraph 33 of IAS 7 are more specific about the classification of cash flows that may arise between an entity and its investments. The following table summarises the requirements of those paragraphs.

Type of cash flow	Classification in IAS 7	Paragraphs in IAS 7 used as reference
Dividends received	Investing or operating activity	Paragraphs 33 and 37–38
Cash payments to acquire interests in joint ventures (or associates)	Investing activity	Paragraphs 16(c) and 38
Cash receipts from sales of interests in joint ventures (or associates)	Investing activity	Paragraphs 16(d) and 38
Cash advances and loans made to *other parties* (ie associates or joint ventures)	Investing activity	Paragraphs 16(e) and 37
Cash receipts from the repayment of advances and loans made to *other parties (ie associates or joint ventures)*	Investing activity	Paragraphs 16(f) and 37

Do the cash flows identified in paragraphs 16(c)–(f) and paragraph 33 of IAS 7 meet the Board's proposed revised definition of 'investing activities'?

8. As we note in paragraphs A2 –A3 of this paper, at its December 2017 meeting, the Board tentatively decided to:

(a) amend the definition of ‘investing activities’ in paragraph 6 of IAS 7 to include dividends and interest received as part of this definition. The Board’s proposed definition of ‘investing activities’ is as follows:

> Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents, and the receipt of interest and dividends.

(b) clarify that dividends received should be part of a non-financial entity’s ‘investing’ activities.

9. Consequently, based on the Board’s tentative decisions dividends received from associates and joint ventures would be classified as investing activities.

10. We think that the other cash flows identified in the table above would also continue to be classified as investing activities because:

 (a) Cash payments to acquire an investment in a joint venture and cash receipts from the disposal of an investment in a joint venture are cash flows derived from the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

 (b) Cash advances/loans that an entity provides to other parties (and the repayment of such advances or loans) are just another form of investment akin to an equity investment but in this case in the form of debt rather than equity. Paragraphs 16(e)–(f) are not specific about the ‘parties’ receiving those cash flows; however we think that associates or joint ventures could be some of the ‘parties’ receiving those cash flows when an entity acts as a capital provider to its associates and joint ventures.

Other cash flows that may arise between an entity and its associates and joint ventures

11. Other cash flows arising between an entity and its investments in associates or joint ventures may meet the definitions of ‘operating’, or even ‘financing’ in paragraph 6 of IAS 7 and be of an ‘operating’ or ‘financing’ nature. For example, some other cash flows that could arise between an entity and its associates and joint ventures are as follows:

(a) fee or royalty payments arising from investment property/technology or trademark agreements between the entity and the investee;

(b) management fees that an investee may pay to the entity. For example, if a joint venture uses the existing administrative/corporate resources of the entity, it may have to pay a management fee;

(c) cash receipts from associates or joint ventures derived from the sale of goods and the rendering of services by the entity to the investee; or

(d) cash payments to associates or joint ventures when associates or joint ventures act as main suppliers of the entity.

12. The staff acknowledge that cash flows of a nature other than 'investing', may arise between an entity and its associates or joint ventures. However, in discussing whether we should require separate presentation of the cash flows of 'integral' and 'non-integral' associates and joint ventures we have focused on investing cash flows only (in Issues 2 and 3 of this paper). This is in line with the Board's approach when discussing the presentation of the share of the profit or loss of 'integral' and 'non-integral' associates and joint ventures in the statement(s) of financial performance. In the statement(s) of financial performance, we are not proposing separate presentation of other income and expenses using the 'integral' and 'non-integral' distinction other than for the share of profit or loss of associates and joint ventures. To require separate presentation of other types of income and expense and their related cash flows would represent a significant change to the existing requirements in other IFRS Standards that is beyond the scope of this project.

Issue 2. Should the Board consider presenting the 'investing' cash flows of 'integral' and 'non-integral' associates and joint ventures separately?

13. At its January 2018 meeting, the Board tentatively decided to require entities to present the share of profit or loss of 'integral' associates and joint ventures separately from those of 'non-integral' associates and joint ventures in the statement(s) of financial performance. In addition, the Board tentatively decided to base this split in the statement(s) of financial performance on:

(a) the Board's proposed definition of 'income/expenses from investments' (ie income/expenses from assets that generate a return individually and largely independently of other resources held by the entity'); and

(b) a non-exhaustive list of indicators to facilitate the 'integral' and 'non-integral' distinction.

Appendix A of this paper summarises these decisions.

14. Given the Board's tentative decision to present separately in the statement(s) of financial performance the share of profit or loss of 'integral' associates and joint ventures from the share of profit or loss of 'non-integral' associates and joint ventures, we think that the Board should also require a similar separation for the cash flows that arise between an entity and its associates and joint ventures.

15. We also think the split between 'integral' and 'non-integral' associates and joint ventures in the statement of cash flows should be on the same basis as the split between 'integral' and 'non-integral' associates and joint ventures in the statement(s) of financial performance.

16. The staff recommend this approach because:

(a) a split between the cash flows of 'integral' and 'non-integral' associates and joint ventures may be beneficial for users. Many users have told us that it is important for their analysis to be able to link income and expenses with their related cash flows. This approach will allow users to analyse both the cash flows and the income and expenses that arise from 'integral' associates and joint ventures separately from the cash flows and the income and expenses that arise from 'non-integral' associates and joint ventures.

(b) identifying 'integral' associates and joint ventures using the same basis for the statement of cash flows and for the statement(s) of financial performance, will promote consistency in the classification of related items in both statements as well as a better alignment with related items in the statement(s) of financial performance.

Staff recommendation

17. For the reasons outlined in paragraph 16, we recommend:

    (a) requiring separate presentation of the cash flows that arise between an entity and its 'integral' associates and joint ventures from the cash flows that arise between an entity and its 'non-integral' associates and joint ventures; and

    (b) requiring that the split between 'integral' and 'non-integral' associates and joint venture should be the same for the statement of cash flows as for the statement(s) of financial performance.

18. In Issue 3 we explore alternatives for the presentation of those cash flows.

Issue 2—Question to the Board
The staff recommend: (a) requiring separate presentation of the cash flows that arise between an entity and its 'integral' associates and joint ventures from the cash flows that arise between an entity and its 'non-integral' associates and joint ventures; and (b) requiring that the split between 'integral' and 'non-integral' associates and joint ventures should be the same for the statement of cash flows as for the statement(s) of financial performance. Does the Board agree?

Issue 3: How should the cash flows of 'integral' associates or joint ventures be presented?

19. The presentation alternatives that we have developed for Issue 3 assume that:

    (a) the entity has investments in 'integral' and 'non-integral' associates and joint ventures and is required to separate the cash flows of 'integral' associates and joint ventures from the cash flows of 'non-integral' associates and joint ventures (from Issue 2 in this paper); and

    (b) the cash flows to/from 'non-integral' associates will be classified as 'investing'. This is consistent both with our proposed definition of investing activities (see paragraph 8) and with their classification in the statement(s) of financial performance.

20. The proposed presentation alternatives also take into account the Board's tentative decisions for the statement(s) of financial performance that have an effect on the reporting of the cash flows from operating activities using the indirect method. These tentative decisions are:

(a) the use of the 'profit before investing, financing and income tax' subtotal as the starting point for the indirect reconciliation of cash flows from operating activities[1].

(b) presentation of the share of profit or loss of 'integral' associates or joint ventures as a separate line item above the 'income/expenses from investments' category and above the 'profit before investing, financing and income tax' subtotal. This means that the share of profit or loss of 'integral' associates and joint ventures would be included in the 'profit before investing, financing and income tax' subtotal[2].

21. The Board's tentative decisions (as described above in paragraph 20(a)–(b)) would mean that the 'profit before investing, financing and income tax' subtotal (as the starting point of that reconciliation) would have to be adjusted for the effects of the share of profit or loss of 'integral' associates and joint ventures in an indirect reconciliation of cash flows.

Presentation alternatives identified for 'integral' associates and joint ventures

22. We have identified three alternatives for the presentation of the cash flows of 'integral' associates and joint ventures in the statement of cash flows:

(a) Approach A: in the operating activities section.

(b) Approach B: in the investing activities section separately from the cash flows from 'non-integral' associates and joint ventures.

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[1] Refer to December 2017 Agenda Paper 21D (Section 1) and December 2017 IASB Update.

[2] Refer to January 2018 Agenda Paper 21B and January 2018 IASB Update.

(c) Approach C: in a separate section, above the entity's 'investing activities' but placed immediately after the entity's operating activities (in line with the presentation proposed in the statement(s) of financial performance).

23. An illustration of all three approaches is presented in Appendix B of this paper.

24. We identify below some advantages and disadvantages of each approach.

Approach A –in the operating activities section

25. Under Approach A an entity would present the cash flows from 'integral' associates and joint ventures as part of an entity's operating activities.

26. It could be argued that Approach A better reflects the business activities of the entity as it would show in the operating category the cash flows from associates or joint ventures that are considered to have a more central (ie integrated) nature and that are closer to the entity's operating activities.

27. A potential disadvantage of Approach A is that this presentation would deviate from the definitions in paragraph 6 of IAS 7 and principles in IAS 7. This is because cash flows considered to be 'investing' in accordance with the Board's proposed revised definition of investing activities, would be presented as part of an entity's operating activities.

Approach B –in the investing activities section

28. Under Approach B an entity would separate the cash flows from 'integral' associates and joint ventures and the cash flows from 'non-integral' associates and joint ventures in the 'investing' section of the statement of cash flows.

29. Unlike Approach A, Approach B is consistent with the Board's proposed definition of 'investing activities' and results in cash flows from both 'integral' and 'non-integral' associates or joint ventures being presented in the 'investing' section of the statement of cash flows.

30. Because Approach B presents both types of associates and joint ventures in the same section it arguably makes it easier for users to locate and assess the 'investing' cash flows that arise between an entity and its investments in associates and joint ventures.

31. A potential disadvantage of Approach B is that it fails to clearly reflect the very wide range of ways equity-accounted investments are used by entities, which means that irrespective of their nature, some ‘investing’ cash flows may be more appropriately classified as operating activities (as in Approach A) or in a separate section closer to operating activities (as in Approach C).

Approach C –in a separate section

32. Approach C would require an entity to present cash flows of ‘integral’ associates and joint ventures in a separate section, above the entity’s ‘investing activities’ but placed immediately after the entity’s operating activities.

33. This presentation has the following advantages:

    (a) it maintains a separation of the cash flows of ‘integral’ and ‘non-integral’ associates and joint ventures, while at the same time indicating the more central (i.e. integrated) nature of particular associates and joint ventures considered to be ‘integral’;

    (b) unlike Approach A it does not classify cash flows that meet the definition of ‘investing activities’ as ‘operating’ activities; and

    (c) the presentation of cash flows from ‘integral’ associates and joint ventures would be aligned with the proposed presentation of the share of profit or loss of ‘integral’ associates or joint ventures in the statement(s) of financial performance –the Board favoured an approach where the share of profit or loss of ‘integral’ associates or joint ventures should be presented as a separate line item above the ‘income/expenses from investments’ category and above the profit before investing, financing and income tax’ subtotal.

34. A major disadvantage of Approach C is that similar to Approach A, it presents cash flows that meet the definition of investing outside the ‘investing activities’ section of the cash flow statement.

35. Another disadvantage of Approach C is that it introduces a fourth section to the statement of cash flows simply to cater for some of the cash flows from ‘integral’ associates and joint ventures. Introducing a new section also adds complexity. This

might be seen as a major change in the current structure of the statement of cash flows.

Staff recommendation

36. The staff recommends Approach B (ie separate presentation of integral and non – integral associates and joint ventures in the investing activities section of the statement of cash flows) for the reasons outlined in paragraphs 29–30.

37. The staff plans to include all three approaches in a due process document, in order to understand constituents' views of the respective merits of each.

Issue 3—Question to the Board
1. Does the Board agree with the staff recommendation to require separate presentation of 'integral' and 'non-integral' associates and joint ventures in the 'investing activities' section of the statement of cash flows (ie Approach B)?

Appendix A –Previous Board discussions

Summary of discussions on the classification of dividends received and on the starting point for the indirect reconciliation of cash flows in the statement of cash flows

Dividends received

A1. At its December 2017 meeting[3], the Board tentatively decided to remove from IAS 7 *Statement of Cash Flows* the options for classification of dividends received (ie as either investing or operating) and prescribe a single classification. The Board did not specifically discuss the classification of dividends received from equity-accounted investments in associates or joint ventures.

A2. The Board tentatively decided to clarify that dividends received should be part of a non-financial entity's 'investing' activities. This is because dividends received:

(a) represent a form of return <u>on</u> a non-financial entity's investments (i.e. the returns that the investment generates separately from its capital value); and

(b) are not cash flows that meet the definition of 'operating activities' in paragraph 6 of IAS 7 (ie they are not derived from a non-financial entity's principal revenue-producing activities).

A3. The Board tentatively decided to amend the definition of 'investing activities' in paragraph 6 of IAS 7 to include dividends received (and interest received) as part of this definition. The proposed definition of 'investing activities' with the proposed amendment included (which has been underlined), is shown below:

> Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents~~.~~, <u>and the receipt of interest and dividends</u>.

[3] Refer to December 2017 Agenda Paper 21C and December 2017 IASB Update.

Indirect reconciliation of operating cash flows

A4. At its December 2017 meeting[4], the Board discussed having a consistent starting point for the indirect reconciliation of cash flows. At that meeting the Board tentatively decided to require a consistent subtotal as the starting point for the indirect reconciliation of cash flows from operating activities. This subtotal should be ‘profit before investing, financing and income tax’.

Summary of discussions on the classification of the share of profit or loss of associates and joint ventures in the statement(s) of financial performance

A5. At its June 2017 meeting[5], the Board discussed the presentation of the share of the profit or loss of associates and joint ventures accounted for using the equity method. Board members generally supported presenting the share of the profit or loss of associates and joint ventures above, rather than below EBIT (i.e. above the *profit before finance income/expenses and tax* subtotal).

A6. At its January 2018 meeting[6] the Board discussed the presentation of the share of the profit or loss of ‘integral’ associates and joint ventures. The Board tentatively decided to require entities to present the results of ‘integral’ associates and joint ventures separately from those of ‘non-integral’ associates and joint ventures as the staff research indicated that users find this split useful for their analysis.

A7. The Board tentatively decided that the basis for the split between ‘integral’ and ‘non-integral’ investments in associates or joint ventures would be the Board’s proposed definition of ‘income/expenses from investments’ (from the November 2017 Board meeting[7]):

> income/expenses from assets that generate a return individually and largely independently of other resources held by the entity.

A8. The Board also proposed including a non-exhaustive list of indicators to facilitate the ‘integral’ and ‘non-integral’ distinction.

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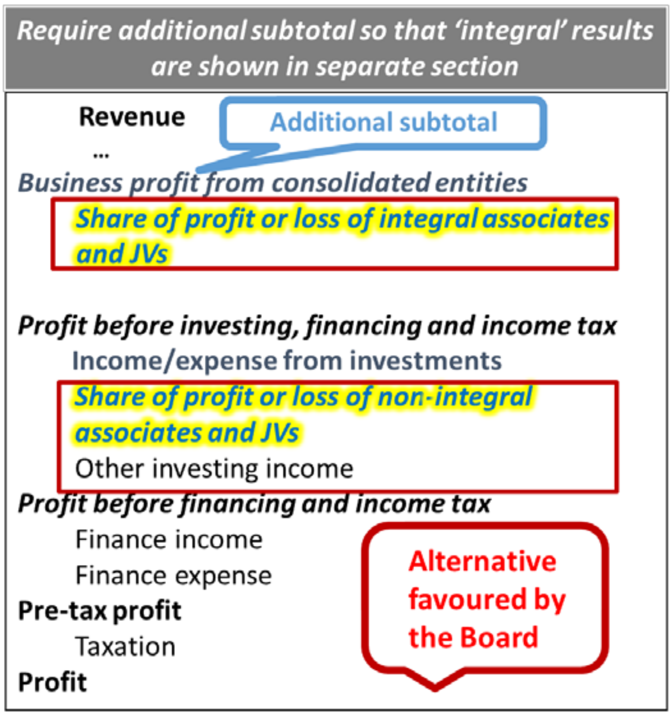
[4] Refer to December 2017 Agenda Paper 21D (Section 1) and December 2017 IASB Update.

[5] Refer to June 2017 Agenda Paper 21E.

[6] Refer to January 2018 Agenda Paper 21B and January 2018 IASB Update.

[7] Refer to November 2017 Agenda Paper 21A and November 2017 IASB Update.

A9. The Board discussed different possible approaches for the presentation of the share of profit or loss of 'integral' and 'non-integral' associates and joint ventures. The Board tentatively advocated the presentation of the share of profit or loss of 'integral' associates or joint ventures as a line item above the 'income/expenses from investments' category and above the 'profit before investing, financing and income tax' subtotal. This presentation is illustrated below.



Appendix B– Presentation alternatives for 'integral' associates and joint ventures

B1 We illustrate on the following page the presentation of the cash flows of 'integral' and 'non-integral' associates and joint ventures under the approaches in paragraph 22 of this paper. We use the 'profit before investing, financing and income tax' subtotal as the starting point for the indirect reconciliation of cash flows[8]. These approaches present cash flows from 'integral' associates and joint ventures as follows:

(a) Approach A: in the operating activities section.

(b) Approach B: in the investing activities section separately from the cash flows from 'non-integral' associates and joint ventures.

(c) Approach C: in a separate section, above the entity's 'investing activities' but placed immediately after the entity's operating activities (in line with the presentation proposed in the statement(s) of financial performance).

B2 We assume that the entity has presented the following statement of financial performance (that has been restructured under the Board's current proposals):

Sales	30,650
Cost of sales	(26,290)
Gross profit	4,360
Depreciation	(450)
Administrative and selling expenses	(910)
Business profit from consolidated entities	3,000
Share of profit of 'integral' joint venture A*	1,090
Profit before investing, financing and income tax	4,090
Income/expenses from investments	
Share of profit from 'non-integral' joint venture B*	950
Profit before financing and income tax	5,040
Financing activities	
Interest expense	(400)
Foreign exchange loss	(40)
Profit before tax	4,600
Taxes on income	(300)
Net profit	4,300

**Notes.* During the period the entity received dividends from Joint Venture A for CU290 and from Joint Venture B for CU200. The entity also acquired 2 new investments, in Associate X for CU740 and in Associate Y for CU550.

[8] In these illustrations we use some of the same data from the example included in the Implementation Guidance in IAS 7 but we make other assumptions to illustrate our discussion in this paper.

Appendix B – Presentation alternatives for ‘integral’ associates and joint ventures

Alternative A: presentation in operating activities		
Cash flows from operating activities		
Profit before investing, financing and income tax		4,090
Income/expense adjustments for:		
Share of profit from 'integral' joint venture A	(1,090)	
Dividends received from 'integral' joint venture A	290	
Profit of joint venture less dividends received		(800)
Depreciation		450
		3,740
Movements in working capital		
Increase in trade and other receivables		(500)
Decrease in inventories		1,050
Decrease in trade payables		(1,000)
Cash generated from operations		3,290
Income taxes paid		(900)
Acquisition of 'integral' associate X		(740)
Net cash from operating activities		1,650
Cash flows from investing activities		
Acquisition of non-integral associate Y		(550)
Purchase of property, plant and equipment		(350)
Proceeds from sale of equipment		20
Interest received		200
Dividends received from 'non-integral' joint venture B		200
Net cash from investing activities		(480)
Cash flows from financing activities		
Proceeds from issue of share capital		250
Proceeds from long-term borrowings		250
Payment of lease liabilities		(90)
Dividends paid		(1,200)
Interest paid		(270)
Net cash from financing activities		(1,060)
Net increase cash and cash equivalents		110
Opening balance		120
Closing balance		230

Alternative B: presentation in investing activities	
Cash flows from operating activities	
Profit before investing, financing and income tax	4,090
Income/expense adjustments for:	
Share of profit from 'integral' joint venture A	(1,090)
Depreciation	450
	3,450
Movements in working capital	
Increase in trade and other receivables	(500)
Decrease in inventories	1,050
Decrease in trade payables	(1,000)
Cash generated from operations	3,000
Income taxes paid	(900)
Net cash from operating activities	2,100
Cash flows from investing activities	
Acquisition of 'integral' associate X	(740)
Acquisition of non-integral associate Y	(550)
Purchase of property, plant and equipment	(350)
Proceeds from sale of equipment	20
Interest received	200
Dividends received from 'integral' joint venture A	290
Dividends received from 'non-integral' joint venture B	200
Net cash from investing activities	(930)
Cash flows from financing activities	
Proceeds from issue of share capital	250
Proceeds from long-term borrowings	250
Payment of lease liabilities	(90)
Dividends paid	(1,200)
Interest paid	(270)
Net cash from financing activities	(1,060)
Net increase cash and cash equivalents	110
Opening balance	120
Closing balance	230

Alternative C: presentation in a separate section	
Cash flows from operating activities	
Profit before investing, financing and income tax	4,090
Income/expense adjustments for:	
Share of profit from 'integral' joint venture A	(1,090)
Depreciation	450
	3,450
Movements in working capital	
Increase in trade and other receivables	(500)
Decrease in inventories	1,050
Decrease in trade payables	(1,000)
Cash generated from operations	3,000
Income taxes paid	(900)
Net cash from operating activities	2,100
Dividends received from 'integral' joint venture A	290
Acquisition of 'integral' associate X	(740)
	1,650
Cash flows from investing activities	
Acquisition of non-integral associate Y	(550)
Purchase of property, plant and equipment	(350)
Proceeds from sale of equipment	20
Interest received	200
Dividends received from 'non-integral' joint venture B	200
Net cash from investing activities	(480)
Cash flows from financing activities	
Proceeds from issue of share capital	250
Proceeds from long-term borrowings	250
Payment of lease liabilities	(90)
Dividends paid	(1,200)
Interest paid	(270)
Net cash from financing activities	(1,060)
Net increase cash and cash equivalents	110
Opening balance	120
Closing balance	230