STAFF PAPER

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Project	**Primary Financial Statements**
Paper topic	Outstanding issues on the statement of cash flows

CONTACT(S)	Frank Fan	ffan@ifrs.org	+44 (0) 20 7246 6442
	Aida Vatrenjak	avatrenjak@ifrs.org	+44 (0) 20 7246 6456

Purpose of this paper

1. This paper discusses two issues relating to the statement of cash flows:
   (a) Issue 1: amending the Board's tentative decision on the starting point for the indirect reconciliation of operating cash flows to reflect the Board's recent tentative decisions on subtotals; and
   (b) Issue 2: applying the Board's tentative decision to remove options for the classification of cash flows from interest and dividends to financial entities.
2. By financial entities, we mean entities that provide financing to customers as a main business activity and/or invest in the course of their main business activities in assets that generate a return individually and largely independently of other resources held by the entity.

Summary of staff recommendations

3. The staff recommend that the starting point for the indirect reconciliation of operating cash flows should be the operating profit subtotal, for all entities (this recommendation amends the Board's December 2017 tentative decision).
4. In addition, the staff recommend that:
   (a) all entities shall classify:

(i) cash flows from dividends paid as financing cash flows; and

(ii) cash flows from dividends received from equity-accounted associates and joint ventures as investing cash flows;

(b) entities that provide financing to customers as a main business activity and/or invest in the course of their main business activities in assets that generate a return individually and largely independently of other resources held by the entity, shall classify each of cash flows from dividends received, interest paid and interest received in a single section of the statement of cash flows; and

(c) such entities shall determine the section in which to classify each of cash flows as follows:

(i) if the entity presents the related income/expenses in a single section of the statement(s) of financial performance, the entity shall present related cash flows in that section; or

(ii) if the entity presents related income/expenses in more than one section of the statement(s) of financial performance, the entity shall make an accounting policy choice regarding the section of the statement of cash flows in which to present related cash flows.

Overview

5. The paper is structured as follows:

(a) Background including previous Board decisions (paragraphs 6–13)

(i) tentative decisions on elimination of classification options for non-financial entities (paragraphs 8–10)

(ii) tentative decisions on scope of subtotals in the statement(s) of financial performance for financial entities and new proposals in AP21A (paragraphs 11–13)

(b) Issue 1: the starting point for the indirect reconciliation of operating cash flows (paragraphs 14–20)

(c) Issue 2: applying the Board’s tentative decisions to remove classification options in the statement of cash flows to financial entities

(i) staff approach (paragraphs 21–24)

(ii) which of the Board decisions on classification of cash flows from interest and dividends can apply to all entities? (paragraph 25)

(iii) what amendments should the Board make for financial entities? (paragraphs 26–46)

(iv) staff recommendation (paragraph 47)

(d) Appendix A: illustration of different starting points for the indirect reconciliation of operating cash flows

(e) Appendix B: illustration of expected effects of Approaches A and B

Background

6. The Board has tentatively decided to make limited changes to the statement of cash flows as part of the project. Those changes are to:

(a) eliminate options for the classification of cash flows from interest and dividends in the statement of cash flows; and

(b) require a consistent starting point for the indirect reconciliation of cash flows.

7. The Board considered but tentatively decided not to align the operating section of the statement of cash flows with a corresponding section in the statement(s) of financial performance.

Tentative decisions on elimination of classification options for non-financial entities

8. Paragraphs 33 and 34 of IAS 7 *Statement of Cash Flows* allow entities to choose how to classify cash flows arising from interest and dividends as shown in the table below:

Cash flow item	IAS 7 classification
Interest paid	Operating or financing
Dividends paid	Operating or financing
Interest received	Operating or investing
Dividends received	Operating or investing

9. The Board tentatively decided to remove these classification options for non-financial entities and require that the cash flows are classified as shown in the table below:[1]

Cash flow item	Classification per Board's tentative decisions
Interest paid	Financing
Dividends paid	Financing
Interest received	Investing
Dividends received	Investing

10. For non-financial entities, the Board also tentatively decided that investing cash flows, such as dividends received, arising between an entity and its equity-accounted investees should be classified as investing cash flows in the statement of cash flows. In addition, investing cash flows from/to integral associates and joint ventures would be presented separately from cash flows from/to non-integral associates and joint ventures.[2]

Tentative decisions on scope of subtotals in the statement(s) of financial performance for financial entities and new proposals in AP21A

11. In September 2018, the Board tentatively decided to permit (or require) some entities to include interest income/expenses and investment income/expenses within the operating profit subtotal.

12. In Agenda Paper 21A for this meeting, the staff are proposing to redraft the model for financial entities discussed in September 2018 to reflect the Board's comments and suggestions made during those discussions. The new proposals are as follows:

    (a) an entity that provides financing to customers as a main business activity is required to include in operating profit either:

        (i) expenses from financing activities and income from cash and cash equivalents relating to its financing business activity; or

        (ii) all expenses from financing activities and income from cash and cash equivalents.

[1] See AP21C December 2017 and the December 2017 IASB *Update*.

[2] See AP21C February 2018 and the February 2018 IASB *Update*.

(b) an entity that, in the course of its main business activities, invests in assets that generate a return individually and largely independently of other resources held by the entity is required to include in operating profit, income (expenses) from investments made in the course of its main business activities.

(c) an entity that provides financing to customers as a main business activity shall not present the 'profit before financing and income tax' subtotal if the entity does not present expenses from financing activities and income from cash and cash equivalents below operating profit. This exception applies even when such an entity presents in the statement(s) of financial performance the unwinding of a discount on liabilities that do not arise from financing activities.

13. Our analysis and recommendations in this paper are based on these new proposals in Agenda Paper 21A.

Issue 1: The starting point for the indirect reconciliation of operating cash flows

14. Paragraph 20 of IAS 7 states that, applying the indirect method, the net cash flow from operating activities is determined by adjusting *profit or loss*; however, we observed variation in the starting point that entities use for determining operating cash flows in the statement of cash flows.[3]

15. In December 2017, the Board tentatively decided to require the subtotal 'profit before investing, financing, and income tax' as the consistent starting point for the indirect reconciliation of cash flows from operating activities.

16. However, subsequent Board decisions have changed the content of that subtotal. The Board has tentatively decided to:

(a) present separately above the 'profit before investing, financing, and income tax' subtotal the share of results from integral associates and joint ventures.

[3] Refer to paragraphs 52–58 of AP21A November 2016.

This decision created an additional subtotal above the share of results from integral associates and joint ventures.

(b) describe this additional subtotal as 'operating profit'.

17. The subtotal that the Board previously decided as the starting point of the reconciliation is now described as 'operating profit and share of profit or loss of integral associates and joint ventures'.

Staff analysis and recommendation

18. Appendix A illustrates the indirect reconciliation of operating cash flows using two different starting points—the 'operating profit' subtotal and the 'operating profit and share of profit or loss of integral associates and joint ventures' subtotal.

19. The staff think that the operating profit subtotal is a more appropriate starting point for the indirect reconciliation of operating cash flows than 'operating profit and share of profit or loss of integral associates and joint ventures', because:

(a) the reconciliation will be more straightforward, without the need to adjust for share of profit from equity accounted investees; and

(b) the reconciliation will be easier to understand, providing a link between operating profit and cash flows from operating activities.

20. As all entities will be required to present an operating profit subtotal, the staff think that this recommendation can apply equally to all entities (both financial entities and non-financial entities).

Question 1
(a) Does the Board agree that operating profit should be required as the starting point for the indirect reconciliation of operating cash flows?
(b) Does the Board agree that this requirement should apply to all entities?

Issue 2: Applying the Board’s tentative decisions to remove classification options in the statement of cash flows to financial entities

Staff approach

21. In making tentative decisions to remove classification options for interest and dividends in the statement of cash flows for non-financial entities, the Board considered the location of the related income and expenses in the statement(s) of financial performance. For example, in deciding that dividends received from investments should be presented in the investing section of the statement of cash flows, the Board noted that, for general corporates, dividend income from investments would be classified in the investing section of the statement(s) of financial performance.

22. The location of interest income or expenses and dividend income in the statement(s) of financial performance for financial entities is different from the location of those income and expenses for non-financial entities. Consequently, this paper discusses how financial entities should classify the related cash flows.

23. We acknowledge that some users of financial statements have said that the statement of cash flows does not provide useful information about the cash flows of some financial entities (for example, banks). However, as discussed in paragraphs 6–7, the Board has tentatively decided to make only limited changes to the statement of cash flows in this project. Consequently, this paper does not fundamentally reconsider the role or the structure of the statement of cash flows for financial entities.

24. The staff have considered:

    (a) which of the Board decisions on classification of cash flows from interest and dividends can apply to all entities (see paragraph 25); and

    (b) what amendments to the Board’s decisions are needed for financial entities (see paragraphs 26–46).

Which of the Board decisions on classification of cash flows can apply to all entities?

25. The staff think the following tentative decisions can apply to all entities:

 (a) classification of cash flows from dividends paid as financing cash flows. This is because, for both financial and non-financial entities, dividends paid are a distribution of profits to the providers of capital and hence should be considered as a financing cash flow.

 (b) classification of dividends received from equity-accounted associates and joint ventures as investing cash flows. This is consistent with the proposals for the structure of the statement(s) of financial performance where the share of results of equity-accounted investees are excluded from the operating profit subtotal of both financial and non-financial entities.

Question 2
Does the Board agree with the staff recommendation that all entities should classify: (a) cash flows from dividends paid as financing cash flows; and (b) cash flows from dividends received from equity-accounted associates and joint ventures as investing cash flows?

What amendments should the Board make for financial entities?

26. The staff think the Board's tentative decisions on classification of interest received, interest paid, and dividends received (from non-equity accounted investees) may need to be modified for financial entities. Applying the proposals for classification in the statement(s) of financial performance for financial entities, some financial entities will present most, or all, of their interest income, interest expenses and/or dividend income in the operating profit section of the statement(s) of financial performance. The staff think it would be counter-intuitive and inconsistent with the Board's approach for

financial entities in the statement(s) of financial performance, if all cash flows relating to interest income, interest expenses and/or dividend income are presented below the operating section of the statement of cash flows for financial entities.

27. We have considered two possible approaches for financial entities:

(a) Approach A ('aligned' approach): align the classification of interest and dividends in the statement of cash flows with the presentation of the related income or expenses in the statement(s) of financial performance; and

(b) Approach B ('single' approach): require each type of interest and dividend cash flow to be presented in a single section of the statement of cash flows.

Approach A (aligned approach)

28. Applying approach A, financial entities would align the classification of interest and dividend items in the statement of cash flows with the presentation of the related income or expenses in the statement(s) of financial performance.

29. Table 1 in Appendix B illustrates the expected classification of cash flows applying approach A for different types of financial entity.

30. In summary, the effect of this approach is that:

(a) cash flows from interest received (except for interest received from cash and cash equivalents—see paragraph 30(c) below) would be:

(i) split between the operating and the investing sections by entities that provide financing to customers as a main business activity and/or invest in debt securities in the course of their main business activity, plus also invest in other debt securities; or

(ii) presented in the operating section by entities that invest in debt securities in the course of their main business activity, and/or provide finance to customers as their main business activity, and do not have other investments in debt securities; or

(iii) presented in the investing section by entities that do not provide financing to customers nor invest in debt instruments in the course of their main business activity.

(b) cash flows from dividends received from non-equity accounted investments would be:

   (i) split between the operating and the investing sections by entities that invest in non-equity accounted equity instruments in the course of their main business activity, plus invest in other equity instruments; or

   (ii) presented in the operating section by entities that invest in non-equity accounted equity instruments in the course of their main business activity, and have no other investments in equity instruments; or

   (iii) presented in the investing section by entities that do not invest in non-equity accounted equity instruments in the course of their main business activity.

(c) cash flows from interest paid and cash flows from interest received on cash and cash equivalents would be:

   (i) in the financing section, for entities that do not provide financing to customers as a main business activity; or

   (ii) in the operating section, or split between the operating and financing section, for entities that provide financing to customers as a main business activity, depending on whether they elect to split related expenses and income or move them all up to the operating profit (refer to proposals in AP21A).

31. The advantage of this approach is that the location of cash flows from interest and dividends in the statement of cash flows is aligned with the location of related income and expenses in the statement(s) of financial performance, meaning that it will be relatively easy for the users of financial statements to identify which cash flows relate to which items of income and expenses.

32. In some cases, this approach would be consistent with current practice—cash flows would be presented in a single section of statement of cash flows. However, in other cases this approach would be inconsistent with current practice as cash flows would be split between the sections of the statement of cash flows.

33. Applying this approach, financial entities would use the same basis for allocation of cash flows between sections in the statement of cash flows as they use for allocation

of income or expenses in the statement of financial performance (ie this approach highlights the relationship between these two statements). In outreach, users have supported approaches that highlight the relationships between the primary financial statements. However, users have also told us they want to see each type of interest and dividend cash flow in a single location, which this approach does not achieve.

34. If a financial entity's accounting system is capable of allocating income and expenses to different sections of the statement(s) of financial performance, it may also be capable of allocating the related cash flows. In such situations, this approach may not be costly to apply. However, this may not always be the case. Consequently, it is not clear whether the benefits of this approach would justify potential costs, given that users of financial statements generally do not make much use of the statement of cash flows for financial entities.

Approach B (single approach)

35. Applying approach B, financial entities would classify each type of cash flow (dividends received, interest paid and interest received) in a single section of the statement of cash flows, even if related income and expenses are in multiple sections in the statement(s) of financial performance.

36. Approach B is similar to the Board's approach to non-financial entities, in that it allocates each type of cash flow to a single section of the statement of cash flows.

37. This approach is also similar to current practice in which entities include each type of cash flow in a single section of the statement of cash flows.

38. However, Approach B would not result in alignment of the classification of interest and dividends between the statement(s) of financial performance and the statement of cash flows.

39. One consequence of this misalignment is that when using the indirect method of reconciliation (assuming the entities would use operating profit as the starting point, as proposed in this paper), entities might need to present additional reconciling items to arrive at net cash from operating activities. For example, let's assume an investment entity classifies dividends received as operating cash flows and this entity also holds investments in equity instruments not made in the course of its main business activity. Income from these investments would be presented below

operating profit. Thus, cash received from dividends for these investments would be an additional reconciling item in the operating section of the statement of cash flows.

How to determine which single section entities should use?

40. The staff have considered two ways to determine in which single section of the statement of cash flows to present each type of cash flows:

    (a) Variant 1: based on which section in the statement(s) of financial performance *most* of the related income/expenses is included.

    (b) Variant 2:

        (i) if an entity presents related income/expenses in a single section of the statement(s) of financial performance, the entity shall present related cash flows in that section; and

        (ii) if an entity presents related income/expenses in more than one section of the statement(s) of financial performance, the entity shall make *an accounting policy choice*[4] regarding which section of the statement of cash flows to present the related cash flows.

41. Applying variant 1, different outcomes are possible for a financial entity. For example, an investing entity may be required to classify interest received as either an operating or investing cash flow, depending on whether the entity, in the course of its main business activity, invests in interest-bearing assets and what proportion of its investing activities relate to interest-bearing assets.

42. Variant 1 relies on a comparison of the relative size of income and expenses in different sections of the statement(s) of financial performance and might result in entities allocating the same types of cash flows to different sections in the statement of cash flows in different reporting periods.

43. This potential variability of outcomes from period to period and somewhat rule-based nature of variant 1 are its main disadvantages.

44. Both variants result in alignment between the statement of cash flows and the statement(s) of financial performance in situations where an entity presents the

[4] Such choice would be treated as an accounting policy as defined by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and disclosed in accordance with paragraph 117 of IAS 1.

income/expense in a single section of the statement(s) of financial performance. However, in situations where the income/expense is included in more than one section of the statement of financial performance, there is no alignment between the statement of cash flows and the statement(s) of financial performance.

45. Variant 2 of approach B does not fully achieve the Board's objective of eliminating classification options in the statement of cash flows. It however reduces those options to instances in which related income/expenses are presented in more than one section of the statement(s) of financial performance. We think these instances would be most common for presentation of interest paid, for entities that both provide financing to customers and have other business activities giving rise to expenses from financing (and do not elect to present them all in the operating profit, as per option proposed in AP21A for this meeting).

46. Table 2 in Appendix B illustrates the expected classification of cash flows applying variant 2 of approach B for different types of financial entity.

Staff recommendation

47. The staff think the benefits of the single approach discussed in paragraph 35 outweigh its disadvantages, and that variant 2 of the approach is preferable, even though it provides an accounting policy choice in some instances. Our main reasons for recommending this approach are as follows:

   (a) it achieves some alignment between the statement(s) of financial performance and the statement of cash flows.

   (b) it results in a simpler presentation of cash flows in that each type of cash flow is in a single section of the statement of cash flows.

   (c) this simpler presentation is consistent with current practice and consistent with the Board's proposed approach for non-financial entities (although presentation outcomes could be different between financial and non-financial entities).

   (d) some users of financial statements have said that the statement of cash flows does not provide useful information about the cash flows of some financial entities. However, comprehensively reconsidering the structure and content of the statement of cash flows is outside the scope of this project. Consequently, we think that a simple approach that is consistent with current practice is desirable until such time that the Board decides to comprehensively address the statement of cash flows for financial entities.

Question 3

Does the Board agree with the staff recommendation that:

(a) entities that provide financing to customers as a main business activity and/or invest in the course of their main business activity in assets that generate a return individually and largely independently of other resources held by the entity, shall classify each of cash flows from dividends received, interest paid and interest received in a single section of the statement of cash flows; and

(b) such entities shall determine the section in which to classify each of cash flows as follows:

(i) if the entity presents the related income/expenses in a single section of the statement(s) of financial performance, the entity shall present related cash flows in that section; or

(ii) if the entity presents related income/expenses in more than one section of the statement(s) of financial performance, the entity shall make an accounting policy choice regarding the section of the statement of cash flows in which to present related cash flows.

Appendix A — Illustration of different starting points for the indirect reconciliation of operating cash flows

Starting point: Operating profit

Cash flows from operating activities	
Operating profit	3,290
Adjustments for:	
Depreciation	450
	3,740
Movements in working capital	
Increase in trade and other receivables	(500)
Decrease in inventories	1,050
Decrease in trade payables	(1,740)
Cash generated from operations	2,550
Income taxes paid	(900)
Net cash from operating activities	1,650

Starting point: Operating profit and share of profit from integral associates and joint ventures

Cash flows from operating activities	
Operating profit and share of profit from integral associates and joint ventures	3,390
Adjustments for:	
Depreciation	450
Share of profit from integral associates and joint ventures	(100)
	3,740
Movements in working capital	
Increase in trade and other receivables	(500)
Decrease in inventories	1,050
Decrease in trade payables	(1,740)
Cash generated from operations	2,550
Income taxes paid	(900)
Net cash from operating activities	1,650

Appendix B — illustration of expected effects of approaches A and B

Table 1— expected effect of Approach A: aligned approach

			Interest paid & Interest received from cash and cash eq.		Interest received from customers	Interest received from investments & Dividends received from non-equity accounted investees
	1	General corporates	Financing for interest paid	Investing for interest received from cash and cash equivalents	Investing	Investing
One main activity	2	Entities whose only main business activity is providing financing to customers (eg traditional banks)	Split: **operating** if related to provision of financing to customers; if not, financing **OR** all operating		**Operating**	Investing
One main activity	3	Entities who invest in the course of their only main business activity (eg investment property companies & insurers)	Financing		**Operating** (rare)	Split: **operating** if related to main business activity; if not, investing
Multiple main activities	4	Entities whose main business activities comprise both investing and provision of financing to customers (eg universal banks)	Split: **operating** if related to provision of financing to customers; if not, financing **OR** all operating		**Operating**	Split: **operating** if related to main business activity; if not, investing
Multiple main activities	5	Entities whose main business activities comprise both a non-financial main business activity and provision of financing to customers	Split: **operating** if related to provision of financing to customers; if not, financing **OR** all operating		**Operating**	Investing
Multiple main activities	6	Entities whose main business activities comprise both a non-financial main business activity and investing	Financing		**Operating** (rare)	Split: **operating** if related to main business activity; if not, investing
Multiple main activities	7	Entities whose main business activities comprise a non-financial main business activity, provision of financing to customers and investing	Split: **operating** if related to provision of financing to customers; if not, financing **OR** all operating		**Operating**	Split: **operating** if related to main business activity; if not, investing

Table 2 — expected effect of Variant 2 of Approach B: single approach based on accounting policy choice when not aligned

			Interest paid	Interest received	Dividends received from non-equity accounted investees
	1	General corporates	Financing	Investing	Investing
One main activity	2	Entities whose only main business activity is providing financing to customers (eg traditional banks)	If entity uses proposed exemption in AP21A=> **Operating** **OR** If entity does not use proposed exemption in AP21A => **Accounting policy choice (Note 1): operating** or **financing**	**Accounting policy choice (Note 2): operating** or **investing**	**Investing**
One main activity	3	Entities who invest in the course of their only main business activity (eg investment property companies & insurers)	**Financing**	**Accounting policy choice (Note 3): operating, investing** or **financing**	**Accounting policy choice (Note 4): operating** or **investing**
Multiple main activities	4	Entities whose main business activities comprise both investing and provision of financing to customers (eg universal banks)	Same as for entity 2	If entity uses proposed exemption in AP21A=> same as for entity 2 **OR** If entity uses does not use proposed exemption in AP21A=> same as for entity 3	Same as for entity 3
Multiple main activities	5	Entities whose main business activities comprise both a non-financial main business activity and provision of financing to customers	Same as for entity 2		
Multiple main activities	6	Entities whose main business activities comprise both a non-financial main business activity and investing	Same as for entity 3		
Multiple main activities	7	Entities whose main business activities comprise a non-financial main business activity, provision of financing to customers and investing	Same as for entity 4		

Note 1: assuming entity has both interest paid on financing activities to fund provision of financing to customers, and interest paid on other financing activities

Note 2: assuming entity has both interest received from providing financing in main business activity, and interest received from other investments

Note 3: assuming entity has more than one of the following: interest received from providing financing in main business activity; interest from other investments, interest from cash and cash equivalents

Note 4: assuming entity has both dividends received from investments made in main business activities, and dividends received from other investment