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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **14 December 2006, London**

Project: **Financial Statement Presentation (Phase B)**

Subject: **The Statement of Cash Flows (Agenda Paper 15B)**

INTRODUCTION

1. This memorandum addresses the following issues related to the statement of cash flows:

   Issue 1: Objectives of the Statement of Cash Flows
   Issue 2: Direct Method vs. Indirect Method
   Issue 3: Reconciliation from Operating Income to Cash Flows from Operating Activities
   Issue 4: Noncash Activities

ISSUE 1: OBJECTIVES OF THE STATEMENT OF CASH FLOWS

2. Before discussing what information should be presented in the statement of cash flows and whether the direct or indirect method should be used, the staff would like the Boards to discuss the objectives of the statement of cash flows that are in the Boards current standards and whether those objectives should be carried forward in this project. The staff is of the view that some or all of the objectives of the statement of cash flows in current standards may be achieved elsewhere in the financial statements under the working format. Thus, it may be more appropriate for those objectives to be

more like working principles or objectives of the standard itself rather than be specific to the statement of cash flows.

Analysis of Current Objectives

3. Paragraph 5 of FASB Statement No. 95, *Statement of Cash Flows,* states that the objective of the statement of cash flows is to help investors, creditors, and others to assess:

    (a) the enterprise's ability to generate positive future cash flows;

    (b) the enterprise's ability to meet its obligations, its ability to pay dividends, and its needs for external financing;

    (c) the reasons for differences between net income and associated cash receipts and payments; and

    (d) the effects on an enterprise's financial position of both its cash and noncash investing and financing transactions during the period.

    As noted in Statement 95, nearly all of the respondents to both the Discussion Memorandum and the Exposure Draft agreed with the objectives of the statement of cash flows (paragraph 49). At the January 2005 Joint International Group meeting, group members discussed the objectives of the statement of cash flows and generally agreed that those objectives were still valid.

Objectives (a) and (b)

4. Objectives (a) and (b) in Statement 95 are embodied in the Objective section of IAS 7, *Cash Flow Statements*, which states:

    > Information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the ability of the entity of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation.
    >
    > The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

5. Those two objectives are also consistent with the decisions made in the Boards' joint project on the conceptual framework. Paragraph OB24 of the Preliminary Views,

Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision–Useful Financial Reporting Information (the Conceptual Framework PV), states:

> Information about an entity's cash flows during a period is another aspect of its financial performance that helps users to assess the entity's ability to generate future net cash inflows. Information about an entity's cash flows during a period indicates how it obtains and spends cash, including information about its borrowing and repayment of borrowing, its capital transactions, including cash dividends or other distributions to owners, and other factors that may affect the entity's liquidity or solvency. Investors, creditors, and others use information about cash flows to help them understand an entity's business model and operations, evaluate its financing and investing activities, assess its liquidity or solvency, or interpret information provided about financial performance.

6. Objective (a) is also consistent with one of the project objectives:

> to present information in the individual financial statements (and among the financial statements) in ways that improve the ability of investors, creditors, and other financial statement users to use that financial statement information (along with information from other sources) to assess the amounts, timing, and uncertainty of an entity's future cash flows.

Thus, the staff is of the view that those two objectives should be carried forward in this project. That is, the financial statements should assist users in assessing an entity's ability to generate future cash flows, meet its obligations, and pay dividends, and its needs for external financing.

Objectives (c) and (d)

7. Objectives (c) and (d) in Statement 95 are not explicitly stated in IAS 7. Consistent with objective (c) (help users assess reasons for differences between net income and associated cash receipts and payments), Statement 95 requires that a reconciliation between net income and cash flows from operating activities be presented either on the face of the statement or in the notes. This reconciliation is not required in IAS 7, although most entities present this reconciliation because they have chosen to adopt the indirect method.

8. Paragraph OB24 of the Conceptual Framework PV states:

> Cash flow information provides a perspective on the entity's economic activities that is different from the one provided by accrual

> accounting—a perspective that is largely free from the measurement and related issues inherent in accrual accounting.

Consistent with that notion, the staff contends that the objective should not be stated in terms of a subtotal, but rather the focus should be on explaining the difference between cash transactions and those based on accrual accounting.

9. While IAS 7 does not refer to noncash transactions in its Objectives section, the staff is of the view that IAS 7 implicitly shares the same objective as that provided in Statement 95 (help users assess the affects of noncash investing and financing transactions). Paragraph 43 of IAS 7 requires the disclosure of noncash transactions:

> Investing and financing transactions that do not require the use of cash and cash equivalents shall be excluded from a cash flow statement. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

10. Paragraph OB25 of the Conceptual Framework PV states:

> Financial reporting should also provide information about changes in an entity's economic resources and claims to them that do not affect cash. Examples include acquiring economic resources in exchange for creditors' claims, settling creditors' claims by transfers of noncash resources, and converting creditors' claims into ownership claims. Investors, creditors and others need that information to understand fully information about an entity's financial position and financial performance. It also helps users understand the information provided about cash flows during a period.

11. The staff speculates that both Statement 95 and IAS 7 refer to noncash **investing and financing** activities because noncash **operating** activities would be presented in the reconciliation for most entities and, therefore, objective (d) is consistent with the Conceptual Framework PV that refers to all noncash activities.

Staff Recommendation

12. As the objectives in Statement 95 are supported by the Joint International Group and consistent with the Boards' decisions in the conceptual framework project, the staff recommends that the objectives of the statement of cash flows in Statement 95 be carried forward in this project as working principles, modified in part, as follows:

Information should be presented in the financial statements in a manner that will help investors, creditors, and others to assess:

(a) an entity's ability to generate future cash inflows;

(b) an entity's ability to meet its obligations, its ability to pay dividends, and its needs for external financing;

(c) the differences between cash transactions and accrual accounting; and

(d) the effects of noncash activities during the period on an entity's financial position.

13. Issues 2 and 3 of this memo addresses how proposed working principles (a)-(c) might be achieved in the financial statements and Issue 4 addresses how proposed working principle (d) might be achieved in the financial statements.

Question for the Boards

1: Should the objectives of the statement of cash flows described in Statement 95 be carried forward (as modified by the staff in paragraph 12) as working principles in the financial statement presentation standard?

ISSUE 2: DIRECT METHOD VERSUS INDIRECT METHOD

14. At the April 2004 joint Board meeting, the Boards decided that the financial statement presentation project should address whether the statement of cash flows should be required or permitted to be prepared under the direct method or the indirect method. The issue was initially classified as part of Phase A, but the Boards subsequently decided at the April 2005 joint Board meeting that this issue should be addressed as part of Phase B.

Current Guidance

15. Statement 95 describes the direct method as a method which reports "major classes of gross cash receipts and gross cash payments and their arithmetic sum" (paragraph 27) and the indirect method as a method which determines and reports "net cash flow from operating activities indirectly by adjusting net income to reconcile it to net cash flow from operating activities" (paragraph 28).

16. Statement 95 refers to two methods of preparing the direct method. The two methods refer to how information is gathered and used to prepare the direct method statement of cash flows; the presentation under both methods should be exactly the same. Under the first method, an entity would record all its cash transactions separately and prepare the statement of cash flows based on those records (the "direct" direct method). Under the second method, an entity would determine the major classes of operating cash receipts and payments by indirectly adjusting revenue and expense amounts for the change during the period in related asset and liability accounts (the "indirect" direct method). For example, under the "indirect" direct method, cash collected from customers would be determined indirectly by adjusting sales for changes in receivables from customers due to an entity's delivery of goods.

17. Statement 95 permits cash flows from operating activities to be presented on the face of the statement of cash flows using either the direct method or the indirect method. If an entity chooses to report cash flows from operating activities using the direct method, it is required to present a reconciliation of net income to net cash flow from operating activities as a separate schedule. The reconciliation is the same as that reported on the face of the statement of cash flows under the indirect method.

18. IAS 7 describes the direct and indirect methods in a manner similar to Statement 95. It also refers to the two methods of preparing the direct method. However, IAS 7 allows an alternative presentation of the indirect method, which does **not** require a reconciliation of net income to cash flows from operating activities. Under that alternative, "revenues and expenses disclosed in the income statement and the changes during the period in inventories and operating receivables and payables" (paragraph 20) are reported. IAS 7 requires the presentation of cash flows from operating activities based on either the direct method or the indirect method; however, it does **not** require a reconciliation when an entity adopts the direct method.

19. While both Statement 95 and IAS 7 encourage an entity to use the direct method, very few entities have chosen to do so for some of the following reasons:

    a. Entities believe it is less costly (on an ongoing basis) to use the indirect method

b. Transitional costs were minimal for most entities that had prepared the statement of changes in financial position under the indirect method

c. Under Statement 95, the direct method was simply additional work because an entity could be compliant with GAAP by adopting the indirect method (that is, adopting the indirect method was economically rational behavior).

Objectives of the Statement of Cash Flows and the Direct and Indirect Methods

20. The proposed categorization scheme in the working format would achieve proposed working principles (a) (help users assess an entity's ability to generate future cash inflows) and (b) (help users assess the entity's ability to meet its obligations, its ability to pay dividends, and its needs for external financing) at least at the category level. The subtotal *cash flows from operating activities* should assist users in assessing an entity's ability to generate future cash flows. That subtotal and the subtotal *cash flows from financing activities* should assist users in assessing an entity's ability to meet its obligations and to pay dividends, as well as its needs for external financing going forward.

21. Similarly, application of the cohesiveness principle to the proposed categorization scheme would achieve proposed working principle (c) (help users assess the differences between cash transactions and accrual accounting), at least at the category level. For example, changes in assets and liabilities due to accrual accounting would be presented as *operating income* in the statement of comprehensive income and changes in assets and liabilities due to cash transactions would be presented as *cash flows from operating activities* in the statement of cash flows.

22. Both the direct and indirect methods achieve proposed working principles (a), (b), and (c) (see paragraph 12) at the category level. The staff is of the view that whether the direct or indirect method should be required or permitted depends on the extent or level to which the Boards want to apply the cohesiveness principle in the proposed working format. That is, if the Boards want the cohesiveness principle to be applied at the line item level, the direct method should be used.

Evolutionary Steps in Cash Flow Reporting

23. Statement 95 counted on voluntary efforts by entities when encouraging the use of the direct method but also permitting the use of indirect method:

> Major change in financial reporting often is the result of an evolutionary process, which may involve interactions between the voluntary efforts of providers of financial statements and the actions of standard-setters. Many areas of financial reporting, and reporting cash flows in particular, have benefited from the voluntary efforts of enterprises to improve their reporting practices. The Board decided that further movement toward a more comprehensive approach to reporting operating cash flows should be permitted to develop as both providers and users of financial statements gain experience with information on cash flows prepared in accordance with the provisions of this Statement. [Paragraph 120]

24. As few entities have adopted the direct method, the FASB's goal of slowly improving financial reporting by gaining experience with different approaches to presenting cash flow information has not been met. As discussed earlier, the staff is of the view that the incentive to adopt the direct method was too low.

25. If the Boards truly believe that the direct method is preferable, they should **require** use of the direct method instead of encourage its use. Requiring the direct method on the face of the statement of cash flows (and thereby eliminating the choice of using the indirect method) would also enhance comparability among entities. The Boards may wish to consider some of the arguments made in the dissents to Statement 95 that relate to the direct and indirect methods (refer to the Appendix).

26. The staff acknowledges that, historically, the Boards reached the conclusion that the direct method is desirable for all categories in the statement of cash flows for conceptual reasons but permitted the use of the indirect method for cost-benefit (or practical) reasons. The following paragraphs revisit those conclusions.

Advantages of the Direct Method

27. The advantages of the direct method (in comparison with the indirect method) can be summarized as follows:

a. The direct method presents what the name of the statement indicates, that is, cash flows[1]. *Net income* and reconciling items do not represent cash flows in and of themselves and, accordingly, the only line item that represents cash flows when using the direct method is the subtotal *cash flows from operating activities*.

b. The direct method would present the difference between **components of** *net income* and associated cash receipts and payments, whereas the indirect method would present the analysis of the difference between certain subtotals (namely, *net income* and *cash flows from operating activities*).

c. The direct method alleviates the concern that *cash flows from operating activities* is an alternative to *net income* as an indicator of an entity's performance. The FASB explicitly rejected this argument when they decided to prohibit the presentation of any cash flow per share amounts in its deliberations that led to Statement 95.

d. The direct method achieves internal consistency within the statement of cash flows, that is, all categories within the statement of cash flows would be prepared based on the direct method. Even under the indirect method, categories other than the operating category are required to be prepared based on the direct method.

e. The direct method is likely to allow an entity to identify and correct misclassifications of cash flows. Under the direct method, payments to suppliers of materials and suppliers of property, plant, and equipment would be aggregated separately. However, if an entity adopting the indirect method inadvertently forgets to reclassify changes in payables related to purchases of property, plant, and equipment (which, under current guidance, should affect *cash flows from investing activities*), both *cash flows from operating activities* and *cash flows from investing activities* would be misstated by the same amount in opposite directions. Because the net misstatement would be zero, it would be difficult for an entity to identify and correct this misclassification.

28. The staff is of the view that these advantages have not changed since the Boards agreed that the direct method is conceptually desirable.

Cost-Benefit Considerations Regarding the Direct Method

Benefits

29. If the direct method is adopted, users of financial statements will benefit from the advantages of the direct method listed in paragraph 27 of this memorandum. However,

[1] One exception would be cash that would have been paid for income taxes if increases in the value of equity instruments issued under share-based payment arrangements that are not included in the cost of goods or services recognizable for financial reporting purposes also had not been deductible in determining taxable income, pursuant to FASB Statement No. 123 (R), *Share-Based Payment.*

some constituents question the benefits of the direct method. These constituents note that:

a. Accrual accounting (the statement of comprehensive income) generally provides a better basis for assessing cash flow prospects than cash transactions (the statement of cash flows)

b. The only information they need and use is the reconciliation, which allows them to assess the quality of earnings (that is, the subtotal presented in the statement of comprehensive income).

Thus, those constituents argue that the additional information provided under the direct method is not necessary.

Costs

30. Some constituents, including members of the Joint International Group, have asserted to the Boards that it is impracticable to prepare the statement of cash flows under the direct method. At the Joint International Group meeting held in January 2005, some group members indicated that it would be difficult for multinational companies that transact in multiple currencies to gather the information required and prepare the statement of cash flows under the direct method in a timely manner.

31. Australia, New Zealand, and other jurisdictions currently require companies to prepare the statement of cash flows using the direct method. One group member of the Joint International Group, whose jurisdiction required the use of the direct method, noted that while an entity would need to make several assumptions in order to prepare the statement, it is not impracticable to implement the direct method. Other constituents contend that, while it may not be impracticable to implement the direct method, the costs would outweigh the benefits. As noted earlier, it is an economically rational behavior to adopt the indirect method under U.S. GAAP; the staff asserts that just because the direct method is unpopular does not mean it should not be viewed as impractical.

32. Continuing to permit use of the indirect method would be less costly for most entities because a significant change to their information (accounting) systems would not be necessary. Requiring the use of the direct method would inevitably result in transitional costs for most entities that have not adopted that method. However, the

degree of difficulty in implementing the direct method would vary depending on the nature of an entity's operations and the features of an entity's current information (accounting) systems.

33. Conceptually, application of the direct method and the indirect method should result in presenting the same amount for the subtotal *cash flows from operating activities.* In order to arrive at the same amount, an entity would generally need to gather information at the same level of detail regardless of what method they use. For example, when adopting the indirect method, the following data needs to be gathered and used to adjust the difference between the beginning and ending balance of working capital items:

    a. Changes in non-operating items included in working capital
    b. Changes in working capital due to acquisitions and disposals
    c. The effects of exchange rate changes.

    If an entity is currently capturing those items correctly, the cost of providing information based on the direct method and indirect method should not differ significantly and, in some cases, it would be more costly to apply the indirect method. While this view contradicts the presumption that the indirect method is less costly to implement than the direct method, empirical studies[2] seem to support this view.

34. Statement 95 was issued in November 1987. IAS 7 was amended in December 1992 to be substantially similar to Statement 95. The environment surrounding information (accounting) systems have developed dramatically since those standards were issued or amended.

35. Some constituents argue that, using the information obtained to prepare the indirect method statement of cash flows, an entity should be able to prepare the cash flow statement under the "indirect" direct method with little incremental cost. While this may or may not be true, the staff notes that empirical studies[3] suggest that the

[2] For example, see Paul R. Bahnson et al, 1996. *Nonarticulation in Cash Flow Statements and Implications for Education, Research, and Practice,* Accounting Horizons 10 (December) pp. 1-15.

[3] For example, see Gopal V. Krishnan and James A. Largay III, 2000. *The Predictive Ability of Direct Method Cash Flow Information.* Journal of Business Finance & Accounting, 27 (1) & (2) (January/March), pp. 215-45.

"indirect" direct method would not provide information that is as accurate as that prepared under the "direct" direct method.

Staff Analysis and Recommendation

36. The staff is of the view that the cohesiveness principle should be applied at the line item level (to the extent possible). That is, an entity should present cash flow amounts for the components of each category rather than only for the category-level subtotals. The staff also is of the view that aggregated amounts at the category level are too broad for users to find them useful. Moreover, internal consistency within the statement enhances the understanding of the statement in its entirety. The staff notes that, even before the Boards started to develop the working format, constituents advocated that the statement of comprehensive income and the statement of cash flows should be aligned by line item.

37. Accordingly, the staff recommends that all categories in the statement of cash flows be presented based on the direct method. This would achieve proposed working principles (a), (b), and (c) not only at the category level, but at the line item level (to the extent possible). (Proposed working principle (d) is addressed in Issue 4.) While the staff acknowledges that costs would be a major concern for preparers, the staff is of the view that, conceptually, the costs between the two methods should not be significant and that the benefits of adopting the direct method outweigh the costs.

38. The staff recommends that the "direct" direct method be used in preparing the statement of cash flows under the direct method. However, if the use of the "indirect" direct method alleviates some of the cost burden on preparers, the "indirect" direct method also should be permitted. (A sample statement of cash flows prepared using the direct method can be found on page 11 of Memo 45D/Paper 15D.)

39. Notwithstanding the above, the staff recommends that the Preliminary Views/Discussion Paper specifically ask for input on the specific costs and difficulties in implementing the direct methods.

40. The staff expects to bring to the Boards (in future meetings) a memorandum that discusses whether there should be a "cash transaction" column in the statement of comprehensive income (or note thereto). Based on the Boards' discussion at the October 2006 joint Board meeting, the staff's current leaning is to require this separate column. The question is whether this "cash transaction" column would provide the same or substantially the same information as the information provided in the statement of cash flows prepared under the direct method. While the staff has not fully explored the definition of "cash transactions," the staff is currently of the view that the information provided in the two statements would be different because the "cash transaction" column in the statement of comprehensive income is likely to include only cash transactions that give rise to income or expense in the current period (such as payment of rent) and cash transactions that are exchanges with assets or liabilities (such as proceeds from borrowings) are unlikely to be included. The statement of cash flows would include both types of cash transactions.

Questions for the Boards

2a. Presuming that the costs of adopting the direct method outweigh the benefits of adopting that method, should all categories in the statement of cash flows be required to be presented under the direct method and the cohesiveness principle be applied at the line item level (to the extent possible)?

2b. Should the use of the "indirect" direct method be permitted if the use of that method alleviates some of the cost burden on preparers?

ISSUE 3: RECONCILIATION FROM OPERATING INCOME TO CASH FLOWS FROM OPERATING CASH FLOWS

41. Currently, Statement 95 requires a reconciliation of *net income* to *cash flows from operating activities* if the direct method is used. That reconciliation is not required by IAS 7.

42. At the January 2005 Joint International Group meeting, group members indicated that information provided in the reconciliation is useful and, therefore, should not be

eliminated even if the Boards decide to require the direct method. The advantages of presenting this reconciliation can be summarized as follows:

a. The reconciliation allows users to assess the quality of earnings (in this case, the quality of *operating income*)

b. The reconciliation allows users to determine the cash flows generated before changes in operating assets and liabilities. Changes in operating assets and liabilities can be viewed as investments, although cash flows related to those changes will not be classified in the investing category. The staff notes that, based on current guidance, some constituents have asserted that the Boards should require the disclosure of the subtotal *cash flows from operating activities before changes in working capital* because it would enable users to assess the cash flows before investments (including investments in working capital).

43. If the reconciliation is retained, it will need to be modified to reflect the proposed working format that

    a. Will not include a *net income* subtotal

    b. Changes the definition of what should be classified as an operating activity (and thus the amount presented as *cash flows from operating activities*).

    If the Boards decide to require use of the direct method (as recommended by the staff), the staff is of the view that the information needed to reconcile *operating income* to *cash flows from operating activities* should be presented in the financial statements.

44. Issue 1 in Memo 45A/Paper 15A on OCI presentation addresses whether OCI items in operating income should be presented separately from non-OCI items (as an interim step). The staff notes that when FASB Statement No. 130, *Reporting Comprehensive Income,* was issued, the FASB decided that the reconciliation should begin with net income and not comprehensive income because "when items of other comprehensive income are noncash items, they would become additional reconciling items in arriving at cash flows from operating activities and would add additional items to the statement of cash flows without adding information content."

45. The staff is of the view that the reconciliation should begin with (comprehensive) operating income inclusive of OCI items. The Boards have decided, as a long-term objective, that there should be no distinction between components of net income and OCI items. Beginning the reconciliation with (comprehensive) operating income inclusive of OCI items would facilitate the transition to that long-term goal.

Staff Recommendation

46. The staff recommends that the information needed to reconcile *comprehensive operating income* to *cash flows from operating activities* be required to be presented in the financial statements. One example of this presentation is illustrated on page 11 of Memo 45D/Paper 15D. However, if the Boards choose Alternative C or D for OCI presentation (that is, to have a separate OCI section) as discussed in Memo 45A/Paper 15A, the staff recommends that the information needed to reconcile *operating income* (which will not include OCI items) to *cash flows from operating activities* be required to be presented in the financial statements.

47. If the Boards agree that reconciling information should be included in the financial statements, the staff will explore how the information can be presented in the financial statements for discussion at a future meeting.

48. The staff has not discussed reconciliations between other items in the statement of comprehensive income and the statement of cash flows (for example, a reconciliation between *investing income* and *cash flows from investing activities*). The staff would like to know if it should explore possibilities of requiring an entity to provide similar information for the investing, financing, and other categories.

Question for the Boards

3a. Should the information needed to reconcile (comprehensive) operating income to cash flows from operating activities be required to be presented in the financial statements?

3b. Should the staff explore whether similar information should be provided for the investing, financing, and other categories?

ISSUE 4: NONCASH ACTIVITIES

49. Issue 1 in this memorandum discusses the objectives of the statement of cash flows. Proposed working principle (d) of the staff recommendation states that the financial statements should present information in a manner that will help users assess the effects of noncash activities during the period on an entity's financial position.

50. The Boards currently have similar requirements regarding the disclosure of noncash activities, namely that information about all investing and financing activities during a period that affect recognized assets or liabilities but that do not result in cash receipts or cash payments in the period are to be reported in related disclosures. The staff is of the view that these requirements should be carried over to the financial statement presentation standard. As discussed earlier, the staff speculates that current guidance refers to noncash *investing and financing* activities because for most entities noncash *operating* activities would be presented in the reconciliation.

51. The staff is of the view that to fully achieve proposed working principle (d), all significant noncash activities should be required to be disclosed along with all relevant information. The staff acknowledges that the information necessary to reconcile comprehensive operating income and cash flows from operating activities (as discussed in Issue 3) would include noncash operating activities; however, if relevant information about noncash operating activities is not or cannot be presented within the reconciliation, that information should be presented in the notes along with information about noncash investing and financing activities.

Staff Recommendation

52. The staff recommends that information about all significant noncash activities during a period should be required to be disclosed in the notes to financial statements.

Question for the Boards

4. Should all relevant information about significant noncash activities be disclosed?

ISSUES TO BE DISCUSSED AT FUTURE MEETINGS

53. The staff plans to discuss the following issues related to the statement of cash flows at future meetings:

   a. The definition of *cash* and *cash equivalents*
   b. Reporting certain cash flows on a net basis
   c. The presentation of cash flows related to acquisitions and disposals of subsidiaries and other business units

d. How to present the information needed to reconcile *(comprehensive) operating income* to *cash flows from operating activities*.

EXCERPTS FROM DISSENTS TO STATEMENT 95

A1. The following paragraphs are excerpts from the dissent to Statement 95 that relate to the direct and indirect methods. Three Board members dissented to the Statement; two of those Board members cited the permitted use of the indirect method as one of the reasons for dissenting.

> Messrs. Lauver and Swieringa also dissent to this Statement's permitted use of the indirect method of reporting net cash flow from operating activities. They believe that by permitting the continued use of the indirect method, the Board has forgone the opportunity to make a significant contribution to the quality of financial reporting and to enhanced user understanding of cash flows from operating activities. Reporting information about cash received from customers, cash paid to suppliers and employees, income taxes paid, and other operating receipts and payments (the direct method) provides a description of the operating activities of an entity during a period that is both more informative and more consistent with the primary purpose of cash flows, which is described in paragraph 4 of this Statement as "to provide relevant information about the cash receipts and cash payments of an enterprise during a period."
>
> Because the indirect method does not result in reporting separately major classes of gross operating cash flows, Messrs. Lauver and Swieringa believe that method is inconsistent with the conclusion in paragraph 11 that "generally, information about gross amounts of cash receipts and cash payments during a period is more relevant than information about the net amounts of cash receipts and payments." Further, permitting use of the indirect method makes this Statement internally inconsistent because major classes of gross cash flows from investing and financing activities are required to be reported separately while major classes of gross operating cash flows are not. In addition, presenting a reconciliation of net income and net cash flow from operating activities within the statement of cash flows rather than in a separate schedule results in including the effects of certain noncash transactions and other events within the statement of cash flows. Messrs. Lauver and Swieringa believe that this is confusing and counter to the primary purpose of a statement of cash flows.
>
> Mr. Lauver believes the internal inconsistencies in the provisions of this Statement concerning the classification of cash flows identified in the preceding paragraphs result from putting other objectives ahead of the Statement's stated objective of providing relevant information about cash receipts and payments. He believes that by adopting the view that the cash effects of transactions and events that enter into the determination of net income are cash flows from operating activities (paragraph 21), this Statement, in spite of comments to the contrary (paragraph 33), attempts to

establish net cash flow from operating activities as an alternative performance indicator, an objective that he believes is undesirable. Further, that objective makes each of the three categories misleading by excluding from investing and financing categories cash receipts and payments that stem from investing and financing activities and ought to be included in those categories. The result is that none of the three categories of cash flows is aptly named and all of them are, therefore, likely to be misunderstood.

Mr. Lauver observes that a statement of cash flows involves no issues of recognition, measurement, or estimation; by definition it includes only the effects of identifiable, unquestioned transactions. In that circumstance, the financial reporting function involves only two tasks. The first is to aggregate similar cash receipts and payments to facilitate communication and understanding and to do so consistently. The second is to accurately characterize the various aggregations so that they are unlikely to be misunderstood. He believes this Statement fails to do either.