30 Cannon Street, London EC4M 6XH, United Kingdom
Phone: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: http://www.iasb.org

International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**22 February 2007, London**
Project:	**Financial Statement Presentation (Phase B)**
Subject:	**Presentation of liquidity information (Agenda Paper 9)**

INTRODUCTION

1. In October 2006, the Boards tentatively agreed that non-financial institutions (non-FIs) should be required to classify assets and liabilities in each of the categories into short- and long-term subcategories on the face of statement of financial position. An asset or liability would be classified as short-term if the shorter of (a) the contractual maturity or (b) the expected realization or settlement of the asset or liability is within one year. (The short-term portion of deferred tax asset or liability would be determined based on the classification of the related asset or liability as described in the paragraph 41 of FASB Statement No. 109, *Accounting for Income Taxes.*) Otherwise, the asset or liability would be classified as long-term. In addition, the Boards tentatively agreed that an entity should present maturity information about its long-term assets and liabilities that have a contractual term (such as contractual receivables and lease obligations) in the notes.

2. In December 2006, the Boards tentatively agreed that financial institutions (FIs) should not be required to present short- and long-term subcategories for each category

on the statement of financial position and asked the staff to develop a principle for presenting liquidity information that would apply to both FIs and non-FIs. Because of that discussion, the Boards acknowledged that they might change their prior decision to require non-FIs to include short- and long-term subcategories for each category on the statement of financial position.

3. This memorandum addresses the concept of liquidity and the liquidity working principle (Issue 1) and application of that working principle (Issue 2). This memorandum does not address presentation of totals and subtotals for assets and liabilities. The staff will revisit the Boards' prior leanings on that issue at a future meeting (along with totals and subtotals for the other financial statements).

ISSUE 1: CONCEPT OF LIQUIDITY

4. Before discussing presentation of liquidity information, the staff would like to start by clarifying the concept of *liquidity*. The liquidity working principle states that "Financial statements should present information in a manner that helps a user assess the liquidity of an entity's assets and liabilities (nearness to cash or time to conversion to cash)." Under this principle, the concept of liquidity reflects the period during which assets and liabilities are converted to or settled by cash.

5. As mentioned in the Memorandum/Agenda Paper for the March 2006 Board meetings, users analyze liquidity over medium- and long-term horizons as well as short-term horizons. The staff asserts that the liquidity working principle should encompass both short-term and long-term liquidity. The staff's understanding is that this notion is implied in the terms *liquidity* and *solvency* as used in the *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information* (the Conceptual Framework PV), which states the following:

> Information about an entity's economic resources and the claims to them—its financial position—can provide a user of the entity's financial reports with much insight into the amounts, timing, and uncertainty of its future cash flows. That information helps investors, creditors, and others to identify the entity's financial strengths and weaknesses and to assess its *liquidity and solvency* (paragraph OB20; emphasis added).

6. In order to align the terms used in the Conceptual Framework PV and the liquidity working principle, the staff recommends that the notion of solvency (the ability to pay debt and other borrowings from external sources as they come due) be added to the working principle.

Question for the Boards

1: Should the liquidity working principle be revised, as follows, to refer to solvency as well as liquidity (and to be consistent with the terms used in the *Conceptual Framework PV)*?

> Financial statements should present information in a manner that helps a user assess an entity's solvency (the ability to pay debt and other borrowings from external sources as they come due) by providing information about the liquidity of the entity's assets and liabilities (nearness to cash, the means to assessing solvency ~~or time to conversion to cash~~).

ISSUE 2: APPLICATION OF THE LIQUIDITY WORKING PRINCIPLE

Presentation of Liquidity Information

7. The staff understands that the short- and long-term subcategorization that the Boards tentatively agreed to for non-FIs is an expedient to providing liquidity information. Such type of presentation may be too simplistic to be useful to someone assessing the solvency of an entity when that entity manages its needs for cash based on a horizon shorter than one year.

8. The staff is of the view that, ideally, **all** entities should be required to provide the same information about their liquidity; the staff recommendation attempts to achieve this objective to the extent possible. In brief, the staff recommends that an entity be required to provide qualitative information regarding its liquidity management activities (refer to paragraph 9) and provide maturity information for its assets and liabilities of a contractual nature (refer to paragraphs 10–15).

Qualitative Information Regarding Liquidity Management Activities

9. Liquidity management activities vary among industries and among entities within the same industry. This is one reason why the long- and short-term subcategorization does not work uniformly for all entities. The staff is of the view that some qualitative disclosure is necessary to achieve the liquidity working principle and recommends that all entities be required to disclose in the notes to financial statements qualitative information regarding its liquidity management activities (liquidity management policy and processes).

Maturity Information

10. To enable a user to assess an entity's solvency, the financial statements should include maturity information for its assets and liabilities with contractual maturities. The staff is of the view that an entity should not be required to present maturity information about assets and liabilities without contractual maturities because those "expected" maturities would be arbitrary at best and would not provide useful information to users of financial statements.

11. As the Boards tentatively agreed in October 2006, the staff recommends that all entities should present in the notes details of maturities of **long-term** assets and liabilities with contractual maturities.

12. Regarding **short-term** assets and liabilities, the staff is of the view that an entity should present in the notes details of the maturities of contractual short-term assets and liabilities into more than one time band if it manages its needs for cash based on a horizon shorter than one year. The staff suggests that guidance similar to the following from paragraph B11 of IFRS 7 *Financial Instruments: Disclosures*, be used:

> In preparing the contractual maturity analysis for financial liabilities required by paragraph 39(a), an entity uses its judgement to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:
>
> (a) not later than one month;
> (b) later than one month and not later than three months;
> (c) later than three months and not later than one year; and
> (d) later than one year and not later than five years.

13. When an entity presents maturity information of this nature (more than one time band less than one year), the staff is of the view that the amounts for both short- and long-term assets and liabilities should be classified by either:

    a. ***the shorter of*** (i) the contractual maturity or (ii) the expected realization or settlement of the asset or liability; or

    b. (i) the contractual maturity ***<u>and</u>*** (ii) the expected realization or settlement of the asset or liability, provided that it is consistent with the entity's liquidity management activities. Under this approach, any major differences between (i) and (ii) should be explained.

14. For an entity that does not manage its needs for cash based on a horizon shorter than one year, the staff is of the view that it should be permitted to present a classified statement of financial position instead of providing maturity information of short-term assets and liabilities in the notes. In this case, all of the entity's assets and liabilities (including those without contractual maturities) would be displayed in short and long-term subcategories. Short-term should be based on a one year notion, which would be based on the shorter of (a) contractual maturity or (b) the expected realization or settlement. Maturity information for long-term assets and liabilities with contractual maturities would continue to be required and, to be consistent with the presentation of the statement of financial position, that classification would also be based on the shorter of (a) contractual maturity or (b) the expected realization or settlement. The staff notes that this decision is consistent with the Boards' decision regarding non-FIs.

Measurement Bases

15. When an entity discloses the details of the maturities of its assets and liabilities the staff is of the view that amounts presented should be based on expected and undiscounted cash flows. In that case, the total cash flows would not necessarily be equal to the amount recognized on the statement of financial position. The staff is of the view that the maturity information provided in the notes should reconcile the differences between total undiscounted cash flows and the amount presented on the statement of financial position.

Summary of Staff Recommendation

16. In summary, the staff recommends that an entity provide the following information in the financial statements:

    a. Qualitative information regarding liquidity management activities (liquidity management policy and processes).

    b. Details of maturities of its **long-term** assets and liabilities with contractual maturities.

    c. Maturities of its **short-term** assets and liabilities as described below:

        i) If an entity manages its needs for cash based on a horizon shorter than one year, the detailed maturities of assets and liabilities with contractual maturities should be provided for more than one time band

        ii) If an entity does not manage its needs for cash based on a horizon shorter than one year, the maturity information may be provided either on the face of the statement of financial position or in the notes. However, if it presents the information on the statement of financial position, all of its assets and liabilities should be classified as either short- or long-term.

17. The staff recommends that an entity that manages its needs for cash based on a horizon shorter than one year classify the maturities of all its assets and liabilities having contractual terms by either:

    a. ***the shorter of*** (i) the contractual maturity or (i) the expected realization or settlement of the asset or liability; or

    b. (i) the contractual maturity ***and*** (ii) the expected realization or settlement of the asset or liability, provided that it is consistent with the entity's liquidity management activities. Under this approach, any major differences between (i) and (ii) should be explained.

    Otherwise, maturity information should be based on the shorter of (a) the contractual maturity or (b) the expected realization or settlement of the asset or liability.

18. In addition, the staff recommends that the amounts presented in the maturity information disclosure be based on expected and undiscounted cash flows. The maturity information should reconcile the differences between total undiscounted cash flows and the amount presented on the statement of financial position.

Question for the Boards

2: Do the Boards agree with the staff recommendation regarding the presentation of liquidity information?