30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410   Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org   Website: www.iasb.org

International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

IFRIC meeting:	**March 2009, London**
Project:	**Guidance on cash equivalents as defined by IAS 7 –** ***Statement of Cash Flow*** **(Agenda Paper 5A)**

INTRODUCTION

1. In December 2008, the IFRIC received a request to provide guidance on the definition of cash equivalents in IAS 7 *Statement of Cash Flows*.

2. The submission specifically asks whether shares in money market funds that are readily convertible and rated as being subject to an insignificant risk of changes in value qualify as cash equivalents under IAS 7.6.

3. For ease of reference, the full text of the request is reproduced in Appendix B.

BACKGROUND

4. The IFRS definition of cash equivalents is:

> "Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value."

5. Paragraph 7 of IAS 7 adds guidance on the maturity, allowing substantially a three-month or less maturity period.

6. Hence, one has to look at all of the following features in order to determine whether investments are cash equivalents:

    a) Convertible at all times (ie a demand deposit)

    b) Into a known amount of cash

    c) Subject to an insignificant risk of changes in value due to both the short time to maturity and the high quality of the underlying financial instrument, and

    d) With a short maturity of three months or less from the date of acquisition.

7. It is possible that these features could be met by instruments held directly or held through an investment vehicle.

8. As a general definition, money market funds are mutual funds that invest in short-term debt instruments. These funds seek to limit exposure to losses due to credit, market and liquidity risks.

STAFF ANALYSIS

9. To begin its analysis, the staff first refers to the definitions of the various categories of financial instruments in IAS 39. More precisely, paragraph 9 of IAS 39 asserts in the definition of loans and receivables that “an interest acquired in a pool of assets that are not loans or receivables (for example, an interest in a mutual fund or a similar fund) is not a loan or receivable”.

10. The staff understands that the Board’s intention in adding this paragraph to the definition of loans and receivables is that whenever looking at a group of financial assets, one has to assess whether each asset meets a set definition/criterion. Only then one may conclude that the whole group falls under this definition/criterion.

11. The staff believes that the above analysis can be applied to investments that might be classified as cash equivalents, especially if these investments are part of a money market fund.

12. The staff is aware that in practice, in some jurisdictions, the use of money market funds is regulated by local exchange commissions. For example in the US, the SEC regulates money market funds through the SEC's Rule 2a-7 of the 1940 act for Registered Investment Companies. Under this rule, money market funds are required to maintain a weighted average maturity of no more than 90 days in addition to meeting the criteria of high liquidity and insignificant risk of change in value. The staff is of the opinion that such regulations would enable entities to conclude that investments in these funds meet the definition of cash equivalents.

13. Therefore, except in the situations described in paragraph 12 of the staff's analysis, the staff believes it is **essential** that all the securities held through an investment vehicle qualify on a standalone basis (were they held directly) for an investment in the vehicle to satisfy the cash equivalent definition.

STAFF RECOMMENDATION

14. The staff has assessed the issue raised in the submission against the IFRIC agenda criteria as follows:

    a) The issue of the classification of investments in money market funds as cash equivalents is a matter of assessing local regulatory requirements against the criteria set out in the cash equivalent definition in IAS 7. The staff therefore does not foresee widespread divergence.

    b) The staff is not aware of any significant divergence in practice.

15. The staff analysis is that the major criteria to add the issue to the IFRIC agenda are not met.

16. The staff believes that the current definition of cash equivalent in IAS 7 is clear enough to address the issue.

17. However, the staff emphasises that money market fund features may vary from one jurisdiction to another and that it is critical that the conditions set out in

paragraph 6 of IAS 7 be carefully looked at in order to determine whether investments in such funds are cash equivalents.

18. The staff has set out proposed wording for the tentative agenda decision in Appendix A.

QUESTIONS FOR THE IFRIC

19. Does the IFRIC agree with the staff recommendation?

20. Does the IFRIC have any comments on the drafting of the tentative agenda decision?

[Appendix A is omitted from Observer note]

APPENDIX B:

Submission

<u>The issue:</u>

<u>IAS 7 Cash Flow Statements – definition of "cash equivalents"</u>

Alongside cash and cash equivalents (cash on hand and demand deposits), the short-term financial assets held by the company include short-term "available for sale" securities, some of which are shares in money market funds and special funds. While the time to maturity of these funds is unlimited, shares in them are readily convertible. It is therefore possible to redeem any number at any time and convert them into cash in one to two working days. They are rated as being subject to an insignificant risk of changes in value.

<u>Question:</u>

Do the securities described above qualify as cash equivalents in the sense of IAS 7.6?

<u>Current practice:</u>

At present the short-term securities described above are classified as cash equivalents in our company accounts, and entered in the cash flow under funds.

<u>Reasons for the IFRIC to address the issue:</u>

This practice, which has been widely adopted by other corporations in the jurisdiction, has now been criticised by the securities regulator. Its main criticism is that the time limitation specified in IAS 7.6 does not apply to shares in such funds. Since this issue has not yet been clarified by the IASB, many corporations and auditors feel bound by the opinion expressed by the securities regulator. If it is necessary to change the present practice, then depending on individual companies' financing strategy it may result in (almost) no funds being posted in the cash flow account.