Project	**Tentative Agenda Decision**
Topic	**IAS 7 *Statement of Cash Flows* – Determination of cash equivalents**

Introduction

1. In April 2009, the IFRIC received a request for guidance on the classification as cash equivalents of fixed deposits or similar instruments with an original term longer than three months. The instruments bear interest at a fixed rate determined at the date of deposit, are redeemable on demand but are subject to a penalty upon early redemption. The amount of the penalty decreases depending on the period the instrument is outstanding. The submission clearly states that the principal amount is always redeemed in full.

Background

2. The IFRIC is already discussing the case presented in Agenda Paper 4 of investments in shares or units of money market funds that are redeemable at any time.

3. The staff's analysis on this issue is that units that don't have a maturity date, but that are readily convertible into an amount of cash that is known at inception and that are subject to an insignificant risk of future changes in value can be considered 'in substance' cash equivalents in accordance with paragraph 7 of IAS 7.

Objective of this paper

4. The objective of this paper is to determine how the analysis and conclusion in Agenda Paper 4 apply to the situation described above.

Staff analysis

5. The staff notes that the fixed deposits meet at least one of the criteria in paragraph 6 of IAS 7 to qualify as cash equivalents as they are instruments that are readily convertible to a known amount of cash, being principal plus accrued interest depending on how long the investments are held.

6. The staff acknowledges though that the definition of cash equivalents in paragraph 6 of IAS 7 includes other criteria such as:

   (a) a 'short term' condition on which paragraph 7 provides guidance: short term would be three months or less from the date of acquisition, and

   (b) an insignificant risk of changes in value.

7. The staff believes that for a fixed rate instrument the 'short-term' criterion is an indicator of the risk of future changes in value as stated in paragraph 8 of Agenda Paper 4. For a variable rate instrument, the 'short term' criterion might also relate to the 'known amount of cash' requirement under some interpretations as discussed below.

8. In the case described in the submission, the fixed deposits have an original six-month maturity and the total amount received on redemption will depend on the remaining period between redemption and maturity dates, but is never less than the original principal amount. The staff believes that this case is virtually identical to one in which the instrument has no fixed maturity at inception and is redeemable on demand for at least the original principal amount, with interest at rates that increase depending on the period the amount is left on deposit.

9. The staff believes that the question the submission raises is how the risk of changes in value should be assessed.

10. At this stage the staff's analyses two views. View A considers that the risk of change in value is to be assessed against the total expected return on maturity rather than against the amount at inception. Under view B, the risk of change in value is assessed against the amount invested.

11. Under view A, the 'known amount of cash' would be the principal and interest expected to be received at the maturity of the investment. In this case, one could argue that an early redemption incurring a significant interest penalty entails a

significant change in value at the date of redemption compared to the expected return upon maturity. This would be consistent with the view that management's intent is rather of an investment than of meeting short term cash commitments as stated in the first sentence of paragraph 7 of IAS 7: 'Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investments or other purposes'.

12. However, the staff questions why the risk of change in value would be assessed against an expected return on redemption or maturity rather than against the amount at inception. This seems to be more relevant for traded instruments issued at a discount (like commercial paper) when changes in interest rates can result in the investor not receiving at least the amount invested if the instrument is sold before maturity. As noted in paragraph 7, the staff believes this is the reason for the three month limit on the maturity of the instrument.

13. Also, the staff notes that management intent is not one of the criteria for an instrument to qualify as a cash equivalent, that is, the staff believes that the first sentence of paragraph 7 is a general description of the purpose of cash equivalents rather than requiring a management representation. The staff is of the opinion that if management's intent is not part of the criteria for instruments to qualify as cash equivalents, the expectation of return on maturity is not relevant to such a classification.

14. Under view B, the 'known amount of cash' is the original amount invested. This is because supporters of view B believe that the purpose of the criteria is to include as cash equivalents only those instruments with essentially the same characteristics as demand deposits which are included in the definition of cash. Such deposits are generally non-interest-bearing and are redeemable on demand at their face amount.

15. Supporters of view B note that there is no requirement for an entity to earn a return on its cash. Paragraph 9 of IAS 7 simply notes that investment of excess cash in cash equivalents is part of an entity's cash management. Consequently, if an entity can at any time obtain an amount that is insignificantly different from the original amount invested, the instrument would be a cash equivalent under view B.

16. In the light of the above analysis, the staff favours view B.

Staff recommendation

17. Based on the analysis in paragraphs 5-15, the staff believes that redeemable fixed-term deposits are cash equivalents because they meet the critical criteria in the definition:

    (a) readily convertible to a known amount of cash throughout their term, and

    (b) subject to an insignificant risk of change in value assessed against the amount at inception.

18. The staff believes that this conclusion is consistent with the conclusion reached in Agenda Paper 4. As a result, the staff recommends that no change needs to be made to the tentative agenda decision to reflect the situation discussed in the submission.

Recommendation and question – wording of the agenda decision
Does the IFRIC agree with the analysis set out in paragraphs 5-15? If so, does the IFRIC agree with the staff's conclusion that the tentative agenda decision does not need to be amended to reflect the specific situation discussed in the submission?