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

## Introduction

1. In March 2009, the IFRIC discussed a request for guidance on whether investments in shares or units of money market funds that are redeemable at any time can be classified as cash equivalents.

## Background

2. Paragraph 6 of IAS 7 gives a definition of cash equivalents which sets out criteria to be met in order for instruments to be classified as cash equivalents — 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. At the meeting in March, the IFRIC agreed with the staff's conclusion that, based on a strict reading of the definition and criteria as well as the additional discussion in paragraph 7, units of money market and other readily redeemable funds do not qualify as cash equivalents. This is because they are essentially equity instruments that have no maturity.

3. Consequently, the IFRIC decided that it needed to consider whether units in money market funds could be in-substance cash equivalents. The IFRIC also decided that the criterion in the definition that cash equivalents must be convertible to known amounts of cash means that the amount of cash that will be received must be known at the time of the initial investment. That is, the units cannot be considered cash equivalents simply because they can be converted to cash at any time at the then market price. This would not necessarily satisfy the criterion that they be subject to an insignificant risk of changes in value.

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IFRIC.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRIC or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

Decisions made by the IFRIC are reported in IFRIC *Update*.

Interpretations are published only after the IFRIC and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

4. The IFRIC exchanged views on possible approaches to making such an assessment including:

   (a) considering the definition criteria in relation to the fund's stated investment policy; or

   (b) 'looking through' the fund to consider the nature of the underlying investments.

5. Some called into question the definition of cash equivalents in IAS 7.

## Objective of this paper

6. The objective of this paper is to provide the additional analysis requested by the IFRIC and make a recommendation on whether the IFRIC should add the issue to its agenda.

## Staff analysis

7. The specific instruments dealt with in the submission that raised the issue are investments in shares of money market funds that basically have no maturity date and that, at the time of the initial investment, are not convertible into a known amount of cash. As such, these money market fund units do not strictly meet the criteria to be cash equivalents. However, as noted in the IFRIC's discussion in March, such a fund could be constructed so that the risk of future changes in value is insignificant.

8. For instruments that have a maturity, the staff believes that the 'short-term' criterion in the definition is an indicator of the risk of future change in value as is the requirement that the amount of cash to be received from the instrument is known at inception.

9. The staff believes that the determination of whether an investment qualifies as a cash equivalent requires assessing it against the criteria in the standard. Consequently, the staff believes that units that don't have a maturity date, but that are readily convertible into an amount of cash that is known at inception are subject to an insignificant risk of future changes in value. They thus meet the critical criteria in IAS 7 and can be considered 'in substance' cash equivalents in accordance with paragraph 7.

10. How an entity makes that determination is a matter of judgement. However, in the staff's view, satisfaction of the criteria should be clear from the terms and conditions of the instrument.

11. The staff also considered the wording in SFAS 95 regarding the assessment of the risk of changes in value. The US standard refers to the risk arising from 'changes in interest rates'. Such a reference is not included in either paragraph 6 or paragraph 7 of IAS 7 so the assessment of potential value changes is not limited to those arising from interest rate risk. The staff concluded that the risk assessment should not be limited to value changes arising from changes in interest rates. Cash equivalents should not be exposed to value changes arising from any risk factors.

## Staff recommendation

12. At the March meeting, the IFRIC concluded that it would not add the issue to its agenda but requested the staff to bring back either proposed wording for a tentative agenda decision or proposed wording for an amendment to IAS 7. As a result of the analysis in this paper, the staff does not believe that an amendment to IAS 7 is required as the essential criteria are clear in the standard. Therefore, the staff proposes wording for a tentative agenda decision in Appendix A.

| **Recommendation and question – wording of the agenda decision** |
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| The staff recommends that the IFRIC should not add this issue to its agenda. Proposed wording for the agenda decision is set out in Appendix A. Does the IFRIC agree with the staff recommendation? Does the IFRIC have any comments on the proposed wording? |

[Appendix A is omitted from the Observer note]