Project **Financial Statement Presentation**

Topic **Statement of cash flows for an entity with funds held on deposit**

Background and introduction

1. IASB agenda paper 7B/FASB memorandum 73B for the January 2010 joint meeting addressed whether a direct method statement of cash flows (SCF) should be required for financial services entities. The staff recommendation in that paper was that a financial services entity be required to present a direct method SCF and present cash inflows and outflows so that the SCF reflects the substance of its transactions (that is, as if they were settled by external funds). After discussing this issue at their individual meetings:

   (a) IASB members asked the staff to do more research and outreach on this issue for discussion at a future meeting

   (b) FASB members asked the staff to provide more information about how an entity might report cash flows related to deposit-taking activities in a direct method statement of cash flows.

2. The purpose of this paper is to follow-up on the questions asked about transactions between entities with depository activities and those depository accounts and to ask board members to reach a decision on how a financial services entity should present cash flow information in its financial statements.

3. This paper includes:

   (a) A simple example of depository activities in the context of direct cash flows (paragraphs 4–10)

   (b) A discussion regarding netting in the context of depository activities (paragraphs 11–17)

   (c) A discussion of the costs and benefits of the staff recommendation (paragraphs 18–20).

Example of possible ways to present cash flows for depository activities

4. The staff was asked to give an example of the depository transactions and the presentation of those transactions in the statement of cash flows. The staff compiled the following simple example.

Facts

5. For simplification purposes, the entity only takes deposits, makes loans, and charges fees on those services.

   (a) 90% of fees are collected directly from depository accounts.

   (b) 25% of loan payments are collected from depository accounts.

   The entity's statement of comprehensive income (SCI) and statement of financial position (SFP) are as follows:

Statement of Comprehensive Income	
	12/31/201Y
Interest income	40,000
Interest Expense	(10,000)
Net Interest	30,000
Fee Income	25,000
Net income	55,000

Statement of Financial Position		
	31-Dec	
	201Y	201X
Assets		
Cash	146,000	200,000
Loans Receivable	780,000	800,000
Interest Receivable	2,000	-
Total Assets	928,000	1,000,000
Liabilities		
Depository Liabilities	(863,000)	(990,000)
Net Assets	65,000	10,000
Equity		
Common Equity	1	1
APIC	9,999	9,999
Retained Earnings	55,000	-
Total Equity	65,000	10,000

Direct method statement of cash flow presentation and disclosure

6. If this entity only reports cash that flows in and out of the doors of the bank (which the staff think may be the case absent guidance otherwise), the direct method SCF will appear as follows:

Statement of Cash Flows	
Inflows from Fees	2,500
Collections of Interest	28,500
Collections of Principle	15,000
Net Deposits/Withdrawals	(100,000)
Net Change in Cash	(54,000)
Beginning Cash	200,000
Ending cash	146,000

7. The **staffs' recommendation** to show flows in and out of the bank <u>and</u> flows in and out of depository accounts together in the direct method SCF would be presented as follows:

Statement of Cash Flows	
Inflows From Fees	25,000
Collections of Interest	38,000
Collections of Principle	20,000
Interest paid/credited	(10,000)
Net change in depository accounts	(127,000)
Net Change in Cash	(54,000)
Beginning Cash	200,000
Ending cash	146,000

8. During the January 13 FASB Education Session, it was suggested that instead of presenting the cash flows between depositor accounts and the entity in the SCF, a **supplemental disclosure** for the cash flows in and out of depository accounts may more informative. This would be presented as follows:

Statement of Cash Flows	
Inflows From Fees	2,500
Collections of Interest	28,500
Collections of Principle	15,000
Net Deposits/Withdrawals	(100,000)
Net Change in Cash	(54,000)
Beginning Cash	200,000
Ending cash	146,000

Supplemental Cash Flow Disclosures	
Interest collected from depository accounts	9,500
Principle collected from depository accounts	5,000
Fees collected from depository accounts	22,500
Interest (charged) to depository accounts	(10,000)

9. The following question was asked during the Education Session: could a user get this information from the **analyses of changes in significant accounts**? The

following is an example of what the entity may or may not include in its analyses of significant accounts:

	Loans receivable	Interest Receivable
Balance 12/31/201X	800,000	-
Interest charged	-	40,000
Cash Settlement of Receivables	(20,000)	(38,000)
Originations made	-	-
Balance 12/31/201Y	780,000	2,000

10. While loan and interest flows are shown above because they were on the entity's SFP, receivable from fees is not a significant line item on the entity's SFP. Therefore, cash received from fees would not be presented in the entity's analysis of significant accounts.

Presenting net amounts of cash receipts and payments

11. In the January joint meeting paper on this issue, the staff did not specify that it envisioned that the current netting guidance for cash flows would remain in place. Therefore some board members presumed that an entity would have to present cash inflows and outflows related to depository activities gross.

12. Whether or not cash flows can be presented net or gross is independent of whether a statement of cash flow is presented using the direct or indirect method. For example, cash flows for investing and financing activities are currently presented directly and some of those cash flows are presented net.

13. Both IAS 7, *Statement of Cash Flows*, and ASC Section 230, *Statement of Cash Flows,* indicate that cash flows qualify for net reporting if, the turnover is quick, the amounts are large, and the maturities are short.

14. IAS 7 and Section 230 also make reference to specific types of cash receipts and cash payments that may be reported net by financial service entities. Those are:

    (a) Deposits placed with other financial institutions and withdrawals of deposits

    (b) Time deposits accepted and repayments of deposits

    (c) Loans made to customers and principal collections of loans.

15. The staff think that (a) and (b) in paragraph 14 fit the criteria detailed in paragraph 13 and would be not meaningful if shown gross. However, the staff note that (c) in paragraph 14 does not necessarily fit the criteria noted in paragraph 13.

16. Furthermore, the staff have heard from analysts that the repayment of a loan by a customer (principal collections) becomes cash available to the entity, at which point the entity may reinvest that cash in additional loans, invest it in other ways, or pay dividends. Analysts we've spoken to have said that knowing the amounts of principal collections may be useful.

Staff recommendation

17. The staff recommend that the guidance in IAS 7 and Topic 230 about the types of cash flows that may be reported net be included in the exposure draft. However, the staff recommend that a financial services entity be required to present gross amounts for loans made to customers and for principal collections of loans. Thus, paragraph 14(a) and 14(b) would be in the exposure draft but 14(c) would not. IASB agenda paper 4F/FASB memorandum 76F [sweep issues] for discussion at the February joint meeting addresses the issue of presenting net cash flows and other net amounts in the financial statements.

Outreach to users and preparers

18. The staff discussed the reporting of cash flows with several entities that have depository activities. We asked how they view transactions with depository accounts and how they would report cash flows from those transactions. The people we spoke to had not given a lot of thought as to whether flows in and out of depository accounts should be reported as cash flows on a direct method statement of cash flows.

19. One entity noted that they consider transactions between the entity and depository accounts within the entity as cash flows, even though no cash moves **in** or **out** of the entity. Currently an entity is required to disclose *cash paid for interest* in its supplementary cash flow information. The people we spoke with noted that

interest credited to depository accounts is in fact included in the *cash paid for interest* amount they report. They arrive at that number by adjusting the change in interest payable for interest expense during the year.

20. This leads the staff to think that including transactions between depositors and the entity in the direct method statement of cash flows would be potentially less costly and result in the "cash paid" and "cash received" numbers that are consistent with the staff recommendation in January.

Staff recommendation

21. The staff continue to support the recommendations made in January, as follows:
    - (a) A financial services entity be required to present a direct method SCF
    - (b) In preparing a direct method SCF, an entity with funds held on deposit should present cash inflows and outflows so that the SCF reflects transactions between the entity and its depositors as if they were settled by external funds.
    - (c) The exposure draft should seek input on the costs and benefits of this type of direct method SCF from preparers, auditors, and users of financial services entity financial statements.

Questions 1–3
Q1. The staff recommend that the guidance in IAS 7 and Topic 230 about the types of cash flows that may be reported net be included in the exposure draft without the specific exception for loans made to customers and principal collections of loans. **Do the boards agree with that recommendation?**
Q2. The staff recommend that financial service entities be required to present a direct method SCF. **Do the boards agree with that recommendation?**
Q3. The staff recommend that an entity with funds held on deposit be required to present a direct method SCF that reflects the cash flows between the entity and depository accounts and that the exposure draft seek input on the costs and benefits of presenting cash flows in this manner. **Do the boards agree with that recommendation**?