STAFF PAPER

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Project	**Disclosure Initiative**		
Paper topic	Debt Disclosures		
CONTACT(S)	Michelle Sansom	msansom@ifrs.org	+44 (0)20 7246 6963
	Amy Bannister	abannister@ifrs.org	+44 (0)20 7246 6947

Objective

1. The objective of this paper is to seek feedback from:
   - (a) investors as to whether the draft proposed disclosure requirement will improve the disclosures about liabilities relating to financing activities; and
   - (b) preparers of financial statements on the costs versus the benefits of the draft disclosure requirements.

Background

2. The IASB is undertaking a narrow-scope project to amend IAS 7 *Statement of Cash Flows* with the objective of improving disclosures about an entity's liabilities relating to financing activities.

3. The narrow-scope project responds to requests from investors who have highlighted that understanding cash flows is critical to their analysis of the entity, and that there is a need for improved disclosures about an entity's debt and the changes in that debt during the period to assist them in verifying their understanding of cash flows.

4. In the early part of 2014 we undertook a short survey with investors to understand what information, if any, investors required about debt when analysing an entity. The results of the survey were presented to the IASB in March 2014 with a recommendation that the IASB should undertake a narrow-scope improvements project to address some of the concerns noted.

5. Existing Standards do not define debt, but they require cash flows to be classified by operating, investing and financing activities. The IASB tentatively decided to explore amending IAS 7 to require a reconciliation of the cash flows for liabilities related to financing activities with amounts included in the opening and closing statement of financial position for those liabilities.

Outline of the draft proposal

6. The draft proposal is to amend IAS 7 by inserting a new paragraph that requires an entity to disclose a reconciliation of the cash flows for liabilities relating to financing activities with amounts included in the opening and closing statement of financial position for those liabilities.

7. The liabilities to be reconciled are those liabilities whose cash flows are or would be classified within financing activities in accordance with paragraph 10 of IAS 7. By using the definition of financing activities in IAS 7, there is no need to define debt, which enables the project to move forward more quickly than if we tried to define debt. Current IFRS does not define debt and finding a commonly agreed definition of debt could take some time and thereby potentially delay the project.

8. The reconciliation is planned to work as follows:

   (a) Paragraph 10 of IAS 7 requires an entity to report cash flows during the period, classified by operating, investing and financing activities.

   (b) Paragraph 6 of IAS 7 defines financing activities as:

   > … activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

(c) Paragraph 17 of IAS 7 notes:

> The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:
>
> a) Cash proceeds from issuing shares of other equity instruments;
>
> b) Cash payments to owners to acquire or redeem the entity’s shares;
>
> c) Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrows;
>
> d) Cash repayments of amounts borrowed; and
>
> e) Cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

9. The new paragraph would require cash flows arising from financing activities (as reported in the statement of cash flows), excluding contributed equity, to be reconciled to their corresponding liabilities in the opening and closing statement of financial position. By excluding cash flows from contributed equity, a reconciliation of the financing liabilities is disclosed.

Illustrative Examples

10. To demonstrate the draft proposal a number of examples have been prepared in Appendix A to this paper.

Question 1
Investors: Do you consider that the draft proposal, as illustrated in Appendix A to this paper, will help improve disclosures about an entity’s liabilities relating to financing activities?

Effects Analysis

11. The IASB is committed to assessing and sharing knowledge about the likely costs of implementing proposed new requirements and the likely ongoing associated costs and benefits of each new Standard—the costs and benefits are collectively referred to as effects. In forming its judgements on the evaluation of the likely effects, the IASB considers several issues. We have shown below our evaluation of the draft proposal against those considerations.

    (a) How the proposed changes are likely to affect how activities are reported in the financial statements of those applying IFRS:

        The draft proposal requires additional information about changes in financing activities (excluding contributed equity). No change is proposed to how activities are reported currently in the financial statements.

    (b) How those changes improve the comparability of financial information between different reporting periods for an individual entity and between different entities in a particular reporting period:

        The draft proposals require a reconciliation of the cash flows for liabilities related to financing activities with amounts included in the opening and closing statement of financial position for those liabilities.

        The reconciliation of opening and closing financing liabilities to the statement of financial position improves users' (investors and analysts) understanding of how the entity finances its activities other than by equity. This improves information as it enables investors to assess the risks and opportunities associated with financing.

        The information contained in the reconciliation itself assists users in understanding the sources of finance and how those sources have been deployed over time.

        A better understanding of the financing structure of an entity (and thereby the risks associated with the structure) improves users' ability to compare and contrast entities and the risks attributable to the entities.

(c) How the improvements to financial reporting will result in better economic decision-making:

Paragraph 4 of IAS 7 notes that cash flow information enables users to develop models to assess and compare the present value of the future cash flows of different entities. Paragraph 5 of IAS 7 notes that cash flow information is useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between the profitability and net cash flow and the impact of changing prices. The reconciliation of liabilities arising from financing activities assists users in verifying their understanding of an entity's cash flows and hence improve economic decision-making.

(d) The likely effect on compliance costs for preparers, both on initial application and on an ongoing basis:

The reconciliation supplements information that is already provided in the financial statements and reconciles between the cash flow statements and the statement of financial position. We do not consider that there would significant additional costs in collating information. Any additional costs are likely to arise from recoding existing data and altering collation systems. As a consequence we do not consider there are likely to significant additional costs to preparers of financial statements.

(e) How the likely costs of analysis for users are affected:

The draft proposal responds to requests from investors (users) of financial statements who have identified the need for improved disclosures regarding debt. We do not consider that there are any significant additional costs for users of financial statements.

Question 2
Preparers: Do you have any comments on the costs versus the benefits of the draft disclosure requirements?

Appendix A—Illustrative Examples supporting draft proposals

Illustrative Example 1

This example shows a possible presentation based on the draft proposal and includes non-cash movements and exchange adjustments as part of the reconciliation. These items are not currently required to be disclosed by IFRS.

Extract from the Cash Flow Statement

	20X2	**20X1**
Financing Activities		
Proceeds from borrowings	-	3,000
Repayment of borrowings	(1,000)	-
Lease payments	(800)	(700)
	(1,800)	2,300
Proceeds from issue of shares and other equity	2,000	-
Transactions with non-controlling interests	-	50
Dividends paid to company shareholders	(300)	(300)
Dividends paid to non-controlling interests	(30)	(25)
Net cash provided by financing activities	(130)	2,025

Notes to the Financial Statements

Liabilities from financing activities

	20X2	**20X1**
Long-term borrowings	21,000	22,000
Short-term borrowings	1,200	1,000
Leases	3,500	4,000
Total financing liabilities	25,700	27,000

Reconciliation of the movement in the year of liabilities from financing activities

	20X1	**Cash flow**	**Non-cash changes**	**Exchange movement**	**20X2**
Long-term borrowings	22,000	(1,000)	-	-	21,000
Short-term borrowings	1,000	-	-	200	1,200
Leases (see note X)[1]	4,000	(800)	300	-	3,500
Total	27,000	(1,800)	300	200	25,700

[1] The IASB proposed this in paragraph 103 of ED 2013/6: *Leases*

Illustrative Example 2

This example includes pensions within the definition of liabilities relating to financing activities to illustrate that management may choose to include pensions within financing activities.

Extract from the Cash Flow Statement

	20X2	**20X1**
Financing Activities		
Proceeds from long-term borrowings	9,000	11,500
Repayments of long-term borrowings	(6,000)	(9,000)
Net decrease in short-term borrowings	(2,160)	(670)
Pension Payments	(300)	(300)
	540	1,530
Repurchase of shares	(5,200)	-
Net increase in non-controlling interests	35	125
Dividends paid	(4,770)	(4,900)
Dividends to non-controlling interests	(465)	(505)
Net cash provided by financing activities	(9,860)	(3,750)

Notes to the Financial Statements

Liabilities from financing activities

	20X2	**20X1**
Long-term borrowings	46,500	43,500
Short-term borrowings	1,000	3,160
Leases (see note X[2])	535	385
Pensions (see note X[3])	2,500	2,600
Fair value of hedges related to long-term borrowings	(470)	(1,560)
Total financing liabilities	50,065	48,085

Reconciliation of the movement in the year of liabilities from financing activities

	20X2	**20X1**
Opening balance	48,085	47,155
Exchange adjustments	(510)	(300)
Net cash flow	540	1,530
Acquisitions	1,900	-
Movement in lease liabilities	150	100
Movement in pension liabilities	(100)	(400)
	50,065	48,085

[2] The IASB proposed this in paragraph 103 of ED 2013/6: *Leases*

[3] A reconciliation of pension liabilities is required in accordance with IAS 19.

Proposed Updates to the Illustrative Example in IAS 7 updated—changes from IAS 7 shown in red[4].

This is a mark-up of changes to the current illustrative example in IAS 7.

Consolidated statement of financial position as at end of 20X2

		20X2		20X1
Assets				
Cash and cash equivalents		230		160
Accounts receivable		1,900		1,200
Inventory		1,000		1,950
Portfolio investments		2,500		2,500
Property, plant and equipment at cost	3,730		1,910	
Accumulated depreciation	(1,450)		(1,060)	
Property, plant and equipment net		2,280		850
Total assets		7,910		6,660
Liabilities				
Trade payables		250		1,890
Interest payable		230		100
Income taxes payable		400		1,000
Long-term debt		2,300		1,040
Total liabilities		3,180		4,030
Shareholders' equity				
Share capital		1,500		1,250
Retained earnings		3,230		1,380
Total shareholders' equity		4,730		2,630
Total liabilities and shareholders' equity		7,910		6,660

[4] In this Staff Paper, currency amounts are denominated in 'currency units' (CU).

Indirect method statement of cash flows (paragraph 18(b))

		20X2
Cash flows from operating activities		
Profit before taxation	3,350	
Adjustments for:		
Depreciation	450	
Foreign exchange loss	40	
Investment income	(500)	
Interest expense	400	
	3,740	
Increase in trade and other receivables	(500)	
Decrease in inventories	1,050	
Decrease in trade payables	(1,740)	
Cash generated from operations	2,550	
Interest paid	(270)	
Income taxes paid	(900)	
Net cash from operating activities		1,380
Cash flows from investing activities		
Acquisition of subsidiary X net of cash acquired (Note A)	(550)	
Purchase of property, plant and equipment (Note B)	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	200	
Net cash used in investing activities		(480)
Cash flows from financing activities (reordered)		
Proceeds from long-term borrowings	250	
Payment of finance lease liabilities	(90)	
Proceeds from issue of share capital	250	
Dividends paid[(a)]	(1,200)	
Net cash used in financing activities		(790)
Net increase in cash and cash equivalents		110
Cash and cash equivalents at beginning of period (Note C)		120
Cash and cash equivalents at end of period (Note C)		230

(a) This could also be shown as an operating cash flow.

Notes to the statement of cash flows (direct method and indirect method)

A. Obtaining control of subsidiary

During the period the Group obtained control of Subsidiary X. The fair values of assets acquired and liabilities assumed were as follows:

Cash	40
Inventories	100
Accounts receivable	100
Property, plant and equipment	650
Trade payables	(100)
Long-term debt	(200)
Total purchase price paid in cash	590
Less: Cash of Subsidiary X acquired	(40)
Cash paid to obtain control net of cash acquired	550

B. Property, plant and equipment

During the period, the Group acquired property, plant and equipment with an aggregate cost of CU1,250 of which CU900 was acquired by means of finance leases. Cash payments of CU350 were made to purchase property, plant and equipment.

C. Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks, and investments in money market instruments. Cash and cash equivalents included in the statement of cash flows comprise the following amounts in the statement of financial position:

	20X2	20X1
Cash on hand and balances with banks	40	25
Short-term investments	190	135
Cash and cash equivalents as previously reported	230	160
Effect of exchange rate changes	–	(40)
Cash and cash equivalents as restated	230	120

Cash and cash equivalents at the end of the period include deposits with banks of CU100 held by a subsidiary, which are not freely remissible to the holding company because of currency exchange restrictions.

The Group has undrawn borrowing facilities of CU2,000 of which CU700 may be used only for future expansion.

NEW NOTE INSERTED

D. Reconciliation of cash flows from financing activities (excluding equity contributions)

	20X1	Cash flow	Acquisition	Other non-cash changes	20X2
Borrowings	1,040	250	200	-	1,490
Leases (see note X)[5]	-	(90)	-	900	810
Long-term debt	1,040	160	200	900	2,300

E. Segment information

	Segment A	Segment B	Total
Cash flows from:			
Operating activities	1,520	(140)	1,380
Investing activities	(640)	160	(480)
Financing activities	(570)	(220)	(790)
	310	(200)	110

[5] The IASB is proposing in ED 2013/6: Leases, paragraph 103.