STAFF PAPER

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IASB Meeting

Project	Disclosure Initiative		
Paper topic	IAS 7 amendments—Cash disincentives		
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Purpose of this paper

1. In December 2014 the IASB published an Exposure Draft of proposed amendments to IAS 7 *Statement of Cash Flows* ('the ED') that included two proposals for the disclosure of:
   (a) a reconciliation of liabilities whose cash flows were classified as financing activities in the Statement of Cash Flows; and
   (b) restrictions that affect the decisions of an entity to use cash and cash equivalents.
2. At its meeting in September 2015 the IASB tentatively decided to finalise the reconciliation of liabilities arising from financing activities, subject to some clarifications to the proposed amendment.[1]
3. Also at its September 2015 meeting, the staff recommended that the IASB did not finalise the amendment regarding cash and cash equivalents, but instead conduct further research in a dedicated project that would look at liquidity disclosures more broadly. However, the IASB asked the staff to try again to develop amendments to IAS 7 related to cash disincentives. The staff were asked to bring a further paper to

[1] IASB update and Agenda Paper 11D of the September 2015 IASB meeting.

the IASB considering whether an amendment could be made to IAS 7 addressing cash disincentives that could be finalised together with the amendments related to the reconciliation of liabilities from financing activities.

4. However, the IASB noted that if staff could not develop the amendments to IAS 7 on a timely basis, finalisation of the reconciliation of liabilities from financing activities should not be delayed.

5. The purpose of this paper is to present a proposed amendment to IAS 7 related to cash disincentives. The IASB will be asked to consider whether to finalise this amendment alongside the amendments to IAS 7 related to the reconciliation and/or continue to work on these proposals as part of a separate project.

6. The paper also includes an analysis of the responses received on the IFRS Taxonomy as a result of paragraph 50A which was initially proposed. An overview of the impact on the Taxonomy resulting from the proposed amendments to paragraph 48 of IAS 7 is also included.

7. This paper sets out:

   (a) the background;

   (b) the proposed amendment to IAS 7;

   (c) staff analysis' of the proposed amendment to IAS 7;

   (d) the staff's recommendation;

   (e) next steps; and

   (f) IFRS Taxonomy.

Background

Development of the proposals in the ED

8. Investors have consistently asked the IASB to require entities to provide a net debt reconciliation. This was highlighted in the Disclosure Forum in 2013. The IASB responded to these requests by proposing an amendment to IAS 1 *Presentation of Financial Statements* (IAS 1) to require such a reconciliation.

9. In October 2013 the IASB decided not to include in the IAS 1 amendments a net debt reconciliation but asked staff to perform further outreach. At this meeting some IASB members were of the view that a net debt reconciliation should be accompanied by better disclosures about cash and cash equivalents.[2]

10. During the course of the project the discussion regarding a net debt reconciliation evolved to a 'gross debt' approach because the IASB identified that it could use the definition of financing activities in paragraph 6 of IAS 7 and propose a reconciliation of the liabilities for which cash flows are classified as arising from financing activities (see paragraphs BC5 and BC6 of the ED).

11. The IASB decided that it would still respond to investors' request to improve disclosures about cash and cash equivalent balances and thus decided to include in the ED paragraph 50A ('the proposed amendment').[3]

The feedback received on the proposed amendment

12. The December 2014 ED included proposals to disclose restrictions that affect the decisions of an entity to use cash and cash equivalents. The staff presented a summary of the feedback to the ED at the June 2015 IASB meeting. The feedback received on the proposed amendment confirmed that users often offset cash and cash equivalents from debt to arrive at a net debt balance and use that balance to understand an entity's ability to use cash holdings to immediately pay debt. This feedback confirms the statement in the ED that this net position is used by the investors to assess a reporting entity's liquidity (see paragraph BC 12 of the ED).

13. We have also heard that the amount of cash holdings (net of debt) is used in enterprise value calculations in order to compare it against the current share price. Such valuation takes into account the entity's potential ability to, amongst other things, perform share buy-backs, acquire businesses, pay dividends, etc.

14. On the other hand, most preparers generally disagreed with the proposed amendment because they thought that in its current form the proposed amendment does not clearly articulate its rationale or because it overlapped with requirements in other Standards

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[2] Feedback from investors has also indicated such views (see paragraph BC10 of the ED).

[3] See paragraphs BC15 and BC16.

(eg paragraph 48 of IAS 7 or paragraph 10 of IFRS 12 *Disclosure of Interests in Other Entities*). Many preparers also disagreed with the proposed amendment for the following reasons:

(a) it would be costly to comply with it, because it might necessitate the consideration of possible outcomes that are subject to complex tax planning; and

(b) the disclosure could be avoided or result in boilerplate because:

  (i) the group treasury function of a reporting entity ensures that all individual companies have access to cash at all times; or

  (ii) the entity intends to retain cash overseas to maximise returns or finance further investments.

15. A more comprehensive feedback summary can be found in paragraphs 36-47 of Agenda Paper 11A for the June 2015 IASB meeting.

Staff proposal in the September IASB meeting

16. At the September 2015 IASB meeting the staff recommended conducting further research on the disclosure of information about disincentives on cash and cash equivalent balances as part of a project that looked at liquidity more broadly. Because the proposed amendment would not include other liquid assets (eg marketable securities) the staff thought that the resulting information could be misleading (see paragraph 21 of this paper). For that reason, and also because of timing concerns regarding the reconciliation of liabilities (see paragraph 4), the staff thought that uncoupling the proposed amendment from the reconciliation proposals would allow more time to arrive at a better solution that would look at liquidity broadly.

17. However, at the September meeting the IASB requested the staff to see if they could develop a possible disclosure requirement that would be operational for preparers and still provide the information that users wanted. IASB members thought that without more transparency around cash and cash equivalent balances, any disclosures of debt reconciliations (or calculations made by users of ‘net’ debt) would result in an incomplete/misleading picture.

18. IASB members also felt that an attempt to achieve the best possible solution to address all scenarios and concerns was not needed and were of the view that any additional information around cash and cash equivalents would lead to better use of such information (see paragraphs 12-13).

The proposed amendment to IAS 7

19. The proposed amendment amends paragraphs 48 and 49 of IAS 7 and introduces a new paragraph 49A (new text is underlined). Paragraph 50A in the ED has been removed, although some of the language in that paragraph has been included in the new paragraph 49A below as follows:[4]

> **48 An entity shall disclose together with a commentary by management the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group <u>or are subject to economic disincentives to their use</u>.**
>
> 49 There are various circumstances in which cash and cash equivalents balances held by an entity are not available for use by the group. Examples include cash and cash equivalent balances<u>:</u>
>
> <u>(a) </u>held by a subsidiary that operates in a country where exchange controls or other legal restrictions apply when the balances are not available for general use by the parent or other subsidiaries<u>; or</u>
>
> <u>(b) held by a subsidiary or branch and which the entity regards as not available for use by the parent, or other subsidiaries or other branches, because the entity has determined that those balances will not be distributed in the foreseeable future (see paragraphs 39-40 of IAS 12 *Income Taxes*).</u>
>
> <u>49A Cash and cash equivalent balances would be subject to economic disincentives to their use if that use would cause costs. An example of an economic disincentive would be tax liabilities that would arise on the repatriation of foreign cash.</u>

[4] Some respondents to the ED showed support for amending paragraph 48 of IAS 7. This is further discussed in the due process paper in the section about the need for re-exposure (Agenda Paper 11C).

Staff analysis of the proposed amendment to IAS 7

20. We think the proposed amendment responds to the concerns raised by respondents in the feedback to the ED (see paragraph 14) and also the IASB in September (see paragraphs 17-18) in the following ways:

    (a) it requires the disclosure of *the amount of cash* subject to the disincentive, rather than of the potential future impact. We think this would address feedback by preparers who were concerned with measuring the potential future impact (ie the costs) or assessing several possible scenarios, because we think it is simpler to provide the amount of cash balances.[5]

    (b) takes into consideration an entity's plans for use of cash and cash equivalent balances by considering how it is has measured its deferred tax liability in accordance with IAS 12. Cash and cash equivalent balances that the entity has determined will not be distributed in the foreseeable future, are treated as not available for use by the group. This treatment is in line with how some entities have characterised cash and cash equivalent balances in the context of liquidity disclosures in management commentary.[6] This would respond to concerns by preparers about the need to consider possible outcomes subject to complex tax planning (see paragraph 14(a));

    (c) clarifies how the proposal relates to paragraph 48 of IAS 7 given that the proposed amendment would amend that very same paragraph;

    (d) we think that the use of the phrase 'subject to' will address concerns that this disclosure ignores the ability of an entity to avoid existing disincentives in the cases which the group treasury function ensures liquidity at all times. This is because 'subject to' implies that the entity has the potential to be affected by the disincentive and if the group treasury function enables an entity to use cash held in a subsidiary or branch without resulting in any

[5] This feedback is in paragraph 42 of Appendix A of Agenda Paper 11E at the September 2015 IASB meeting.

[6] An example of such characterisation is in a response to a SEC comment letter (page 3) where an entity suggests the disclosure of the amount of foreign cash holdings—there are other examples.

existing disincentive then such an entity is *not subject* to that disincentive—no disclosure would be needed.[7]

21. However, the staff still have some concerns with the proposed amendment. In particular this amendment would require the disclosure of disincentives related to cash and cash equivalents only. This means that disincentives relating to an entity's other liquid assets (eg marketable securities) would not be captured by the proposed amendment (although an entity would not be prevented from disclosing those disincentives). We have heard that preparers and users often use other liquid assets (eg highly liquid marketable securities) *together* with cash and cash equivalents to offset gross debt to arrive at a net debt figure. We understand that some entities hold a significant amount of their liquid assets in the form of marketable securities (particularly given the low interest environment in many countries).

22. Some would consider that not disclosing the disincentives on other liquid assets could provide a misleading or incomplete picture to users, especially if the amounts of marketable securities are substantial. It follows that the disclosure of the disincentives only on cash and cash equivalents could wrongly suggest to users that there were no disincentives on other liquid assets balances.

23. Feedback has indicated that entities have procedures and processes in place to manage their liquidity and that the fact that a disincentive exists does not mean that the entity would be impacted by it—thus an entity may disclose disincentives that would never have an effect. Some preparers have indicated that such disclosure of disincentives is of little value to users because it is disconnected from how they manage liquidity internally.

Question 1 for the IASB

Do you agree with the proposed amendment in paragraph 19 and that it responds to the feedback received on the proposals in the ED as set out in paragraphs 20–23?

[7] This may be something further explained in the Basis for Conclusions.

Next steps

24. Although we think the proposed amendment addresses many of the concerns raised about the proposal in the ED, we think we need further time to test whether it is operational in practice. If the IASB agrees with the staff, that further field testing is required, we think that the IASB has the following options to keep moving ahead with this issue:

    (a) separate this work on cash disincentives from the amendments to IAS 7 regarding the reconciliation ie decouple the IAS 7 amendments; or

    (b) delay the package of IAS 7 amendments.

Decouple the IAS 7 amendments

25. The first option is to decouple the cash disincentives amendment from the reconciliation of liabilities. We think that this option has the following advantages:

    (a) more time to test the proposed amendment in paragraph 19;

    (b) enables the amendments to IAS 7 on the reconciliation be finalised by the end of the year. This would allow for an effective date of 1 January 2017; and

    (c) if the proposed amendment in paragraph 19 is not operational, this option permits the IASB to continue research on this matter as a broader project looking at disclosures on liquidity (see paragraph 33) without unnecessarily delaying the finalisation of the amendments to IAS 7 regarding the reconciliation.

26. We think that the disadvantage of this option is that, if the proposed amendment on cash disincentives does prove to be operational, we may need to publish two separate due process documents on amendments to IAS 7.

Delay the IAS 7 amendments

27. The IASB tentatively decided in the September 2015 meeting that the reconciliation of liabilities should be finalised regardless of the outcome of the cash disincentives

amendment. However, we think that the option of delaying both amendments has the advantage of allowing them to be finalised together and published as a package. This would respond to IASB members' concerns in regards of having the cash disincentives disclosure together with the reconciliation.

28. We think that the disadvantage of this option is that we would delay the disclosure of the reconciliation of liabilities, which is a long standing request from investors. If the testing of the proposed amendment on cash disincentives is positive, we would envisage that the package of amendments to IAS 7 would not be finalised until the first quarter in 2016 at the earliest, with an effective date of 1 January 2018. In addition, further consultation in regards to the proposed amendment in paragraph 19 could lead to a conclusion that the proposed amendment is not operational, meaning that the delay of finalising the amendments to IAS 7 about the reconciliation was not necessary in the first place.

Staff recommendation

29. On the basis of the advantages and disadvantages discussed in paragraphs 25-28 we recommend the IASB to decouple the amendments to IAS 7. This would allow for staff to undertake further outreach with preparers to understand if the proposed amendment on cash disincentives in paragraph 19 is operational, without impacting the timing for the finalisation of the amendments to IAS 7 on the reconciliation.

Question 2 for the IASB
(a) Does the IASB agree that we should undertake further testing of the proposed amendment on cash disincentives in paragraph 19 or do you think the proposals can be finalised now? (b) If you agree that further testing of the proposed amendment is required, do you agree with the staff recommendation in paragraph 29?

Due process - next steps

30. The answers to Question 2 in this paper will result in different outcomes for the project:

(a) if, in response to Question 2(a) the IASB decides finalise the proposed amendment now, the disincentives proposal would be finalised and issued together with the reconciliation.

(b) if the IASB answers 'yes' to Question 2(b), the disincentives proposals would be decoupled from the reconciliation and the reconciliation would be finalised and issued separately.[8]

31. Both outcomes are included in Agenda Paper 11C (the Due Process paper) which presents to the IASB two different appendixes (one for each potential outcome). This is further explained in that paper.

32. If the IASB answers 'no' to Question 2(b) and chooses the option to delay the IAS 7 amendments then Agenda Paper 11C should be disregarded.

Next steps for this topic

33. Regardless of the IASB's decision on whether or not to include the proposed amendment in the final amendments to IAS 7, we recommend that the IASB should look at liquidity disclosures more broadly, as a response to the feedback received and to the discussions with the IASB. The staff would discuss the scope of such work with the IASB in future meetings, and would also discuss, after considering responses to the Agenda Consultation, which project would be the most suitable vehicle for that work.

Question 3 for the IASB
Does the IASB agree with staff recommendation in paragraph 33?

[8] This is in accordance with the IASB's tentative decision in the September 2015 IASB meeting.

IFRS Taxonomy

Background

34. The IASB is holding a trial of a proposal to change the IFRS Taxonomy due process. The ED has been used to trial the process. It includes the proposed IFRS Taxonomy Update accompanying the ED, but not forming a part of it. This is the first time that the proposed changes to the IFRS Taxonomy have been included in an ED.

Tax liabilities that would arise on the repatriation of foreign cash and cash equivalent balances

Exposure Draft

35. The proposed paragraph 50A of IAS 7 would have required an entity to consider matters such as restrictions that affect the decisions of an entity to use cash and cash equivalent balances, including tax liabilities that would arise on the repatriation of foreign cash and cash equivalent balances.

36. In order to represent the proposed amendment in the IFRS Taxonomy, the following element was proposed: 'Tax liabilities that would arise on repatriation of foreign cash and cash equivalent balances'. This element was a monetary type element, which implied that the proposed amendment required an entity to disclose a numeric amount.

Feedback received

37. Of those who responded to how the proposed amendments should be reflected in the Taxonomy, most expressed the view that the proposed labels of elements faithfully represent their meaning. Some, on the other hand, highlighted that the wording of paragraph 50A suggested that the proposed element 'Tax liabilities that would arise on repatriation of foreign cash and cash equivalent balances' should be qualitative rather than quantitative.

Staff analysis

38. On the basis of the feedback received, we were concerned that respondents considered the requirement to be unclear. It might have been interpreted as requiring either quantitative or qualitative information.

39. The recommendation made in paragraph 29 to amend existing paragraphs 48 and 49 of IAS 7 and to exclude the proposed paragraph 50A addresses this concern of the staff. Amended paragraph 48 requires two additional line items which can be modelled into the Taxonomy. One as a qualitative disclosure (ie commentary by management) and the other as a quantitative disclosure (ie the amount of cash and cash equivalents).