STAFF PAPER

September 2015

IASB Meeting

Project	Disclosure Initiative
Paper topic	IAS 7 amendments—Cash restrictions (disincentives)

CONTACT(S)	Eduardo Baldoino	ebaldoino@ifrs.org	+44 (0)20 7246 6462
	Richard Fraser	rfraser@ifrs.org	+44 (0)20 7246 6958
	Michelle Sansom	msansom@ifrs.org	+44 (0)20 7246 6963

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'). The objectives of the proposed amendments are to improve:

   (a) the information provided to users of financial statements about an entity's financing activities, excluding equity items ('the reconciliation'); and

   (b) disclosures that help users of financial statements to understand the implications that affect the decisions of an entity to use cash and cash equivalent balances ('cash restrictions (disincentives)').

2. The purpose of this paper is for the IASB to consider the staff's analysis of the feedback on the proposals about cash restrictions (disincentives) (see paragraph 1(b)) and to recommend the next steps in this part of the project. This paper also includes an analysis of the feedback received in relation to the IFRS Taxonomy modelling of the ED (see paragraphs 40–44).

3. Agenda Paper 11D at this meeting brings a follow-up discussion to the IASB on the proposals about the reconciliation (see paragraph 1(a)).

4. A feedback summary of the responses to the ED was presented in Agenda Paper 11A of the June 2015 IASB meeting. Because the IASB did not complete its discussions on the feedback, we have included the cash restrictions section of the feedback summary in Appendix A for reference.

Background

5. Paragraph 50A ('the proposed amendment') was included in the ED together with the proposed amendment for the reconciliation of liabilities whose cash flows are classified as financing activities (see Agenda Paper 11D at this meeting). This was to address the input the IASB had received from users that disclosures are needed to supplement paragraph 48 of IAS 7 regarding cash and cash equivalent balances held by the entity that are not available for use by the group (see paragraphs BC10-BC12 of the ED).

6. We have heard that in their models users often offset cash and cash equivalents from debt to arrive at a net debt balance. We have also heard that users are concerned that cash and cash equivalents are not always available to settle debt, because there may be some form of economic restriction in place that limits access to the full amount of cash. As a result the proposed amendment attempted to capture such economic restrictions that would normally not be captured by paragraph 48 of IAS 7 or other IFRS requirements.

7. The Exposure Draft stated:

> Additional information may be relevant to an understanding of the liquidity of an entity. An entity shall 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. If these, or similar, matters are relevant to an understanding of the liquidity of the entity, those matters shall be disclosed.

Staff recommendation

8. We recommend the IASB not to finalise the amendments at this time to conduct further research in a dedicated project that would look at liquidity more broadly.

Staff's analysis of the concerns raised in the feedback

9. The feedback we have received (both in the comment letters and outreach) raised concerns about the proposed amendment. While users, regulators and standard-setters widely supported the proposed amendment, most preparers and auditors disagreed with it.[1]

10. We set out the following concerns to be discussed with the IASB:

 (a) the term 'restrictions' (paragraphs 11–16);

 (b) defining whether the cash is subject to disincentives (paragraphs 17–29);

 (c) clarifying the objective of the proposed amendment (paragraphs 30–33);

 (d) difficulties in meeting the objective (paragraphs 34–39); and

 (e) feedback on the IFRS Taxonomy (paragraphs 40–44).

The term 'restrictions'

11. A few respondents suggested not using the term 'restrictions', because it does not reflect what the proposed amendment is trying to capture (ie the cash is not in fact restricted; instead, it is subject to cost if the cash is used to settle the group's debt). In their view the term 'restrictions' might be interpreted in its narrower sense, ie something that simply cannot be accessed.

12. We think the use of the term 'restrictions' caused confusion because:

 (a) the term is also used in other Standards (for example, paragraph 10 of IFRS 12 *Disclosure of Interests in Other Entities*) to mean cash that cannot be used or accessed by the entity; and

[1] See paragraphs 37 and 43 of Appendix A.

(b) ‘restricted’ cash is a term sometimes used by entities in order to comply with paragraph 48 of IAS 7 when disclosing cash that is not available to be used (see Appendix B).

13. Both instances mentioned in paragraph 12 consider restriction to be equivalent to ‘not available’. However, this is different from how the proposed amendment used the term restriction.

14. In our view the proposed amendment was not intended to include cash that cannot be used or accessed—this is already required by paragraph 48 of IAS 7. The intention of the proposed amendment was to require disclosures for cash that an entity *has* the ability to use or access *but* is subject to disincentives if the cash was moved to settle the group’s consolidated debt. Examples of such disincentives include income tax or penalties for breaches of covenants that would result from moving the cash across the group structure.

15. Thus, the proposed amendment focused on the disclosure of existing conditions that would discourage an entity from moving cash balances across the group structure. In the light of this focus, we think that ‘disincentives’ instead of ‘restrictions’ is a more appropriate wording to show what the proposed amendment is trying to achieve. The definition of disincentive in the *Oxford Dictionary of English* is:

> A factor, especially a financial disadvantage, that discourages a particular action.

16. From now on and throughout this paper we use the term disincentive instead of restriction.

Defining whether the cash is subject to disincentives

17. Feedback from preparers has indicated that disclosures about the existence of a disincentive to move cash between group entities may not be useful information about liquidity, because the group treasury function of an entity would aim to ensure that subsidiaries have access to cash at all times (see paragraph 45(b) of Appendix A).

18. We agree with this feedback because we think there can be many ways in which an entity, especially large multinationals, can move or effectively access cash to pay liabilities without crystallising the effects of any disincentive.

19. Consequently, we think it could be challenging for preparers to determine what portion of cash is subject to disincentives, given all the different ways by which an entity can access a cash balance that is subject to a disincentive.

20. Because of this difficulty, we think we have to clearly differentiate the fact that a disincentive *exists* from the fact that the disincentive is *affecting* the entity. We think this differentiation should be based on what information users want, also taking into consideration the many ways by which an entity can access cash when a disincentive exists. Thus, we analyse the following:

    (a) the information users want; and

    (b) determining that the cash is in fact *subject to* disincentives.

The information users want

21. The feedback we have received during our outreach identified that users could use the information resulting from the proposed amendment in different ways. However, the consistent feedback among users was the need to understand an entity's ability to use cash holdings to immediately pay debt. This feedback is consistent with input prior to the ED, which indicated that investors often offset cash and cash equivalents balances from debt to calculate a net position (see paragraph BC12 of the ED). One user pointed out the following in its response to the ED:[2]

> … We analyse the specifics of a company's cash holdings to evaluate how much of its cash is immediately accessible to reduce debt. To calculate how much cash can be netted off from debt, and unless we get enough information or identify analytical reasons supporting a lower or higher haircut, we will deduct 25% from the available cash …

22. Some aspects regarding the availability of an entity's cash are already required to be disclosed by paragraph 48 of IAS 7, which requires the disclosure of cash that is not available for use by the group.[3] Users consider that other aspects that relate to the availability of cash are not captured by paragraph 48 and that the proposed

[2] Comment letter 100 Standard & Poor's Ratings Services, paragraph 234 of the Appendix to the letter.

[3] An example that would be captured by paragraph 48 of IAS 7 is 'cash and cash equivalent balances 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' (paragraph 49 of IAS 7).

amendment would fill that gap. These other aspects relate to the instances in which an entity *has the ability* to use the cash but doing so would trigger undue costs.

23. Feedback from users indicates that most of these instances are a result of tax effects on the repatriation of cash. Other examples include covenants that would be breached if cash was transferred from a specified subsidiary to another member of the group.

Determining whether the cash is in fact subject to disincentives

24. Preparers have told us that the existence of a disincentive to use cash balances does not necessarily result in that disincentive actually occurring. Consequently, they believe that the proposed amendment could be avoided (see paragraph 17).

25. We think this view reflects an assumption that an entity can *always* avoid the disincentive. We do agree that the existence of a disincentive does not automatically mean that it will affect the entity's ability to settle liabilities, because, as discussed in paragraph 18, the entity has many ways to avoid such disincentive.

26. Considering what information users want (see paragraphs 21–23) and contrasted with the feedback from preparers that an entity can *avoid the disincentives from crystallising into an actual expense*, we think that the proposed amendment needs to focus more on the ability of an entity to avoid the disincentive than on the fact that the disincentive exists. We think that the proposed amendment should clarify that the cash would only be *subject to* disincentives if the entity has *no practical ability* to avoid the disincentive. It would ultimately be a matter of judgement by the entity to determine whether it has the practical ability to avoid an existing disincentive or not, based on its many internal or external alternatives.

27. Another related issue is that feedback identified that users want to know how much cash is immediately available *to settle liabilities* (see paragraph 21). This would mean that users would be interested in knowing the existing disincentives only in those subsidiaries whose cash exceeds their liabilities. This is because even if cash balances in a subsidiary are subject to disincentives, the entity can still use them to settle liabilities in that subsidiary without incurring in any disincentive. This thinking implies that even with existing disincentives the cash would still be available to *settle liabilities*.

28. Summarising the thinking in paragraphs 26 and 27, we think that the proposed amendment could define cash that is *subject to* disincentives as an entity's cash holdings that:

    (a) are held *in excess of* liabilities in a subsidiary (ie there is more cash than liabilities);

    (b) if transferred across the group structure, would result in economic disadvantages such as undue costs due to additional income taxation or penalties resulting from breaches of covenants; *and*

    (c) the entity has no ability to *immediately* access or use it to pay liabilities without resulting in the economic disadvantages mentioned in (b).

29. This definition would then be used in the stated objective of the proposed amendment, which is discussed in the next section.

Clarifying the objective of the proposed amendment

30. Many respondents to the ED suggested that, in its current form, the proposed amendment does not clearly articulate the rationale or the objective of the proposed disclosure (see paragraph 41 of Appendix A).

31. We think that using the definition of cash *subject to* disincentives in paragraph 28 will clearly articulate under what conditions the disclosure would be necessary, avoiding some of the confusion identified in the feedback.

32. In addition, many respondents asked whether the proposed amendment should result in qualitative or quantitative disclosures. Respondents also mentioned that in some instances it may be impractical to measure the financial impact that the disincentives would cause and claimed that the proposed amendment would require information about the future (see paragraph 42(b) of Appendix A). In order to respond to that, we think the proposed amendment could clearly state that an entity should disclose the nature and, if practicable, the extent of the cash balances that are subject to disincentives. This would therefore result in the disclosure of both qualitative information (ie the nature) and, if practicable, quantitative information (ie the amount of cash balances) information.

33. As a result, in our view the objective of this disclosure is to help users to understand how much of the cash and cash equivalent balances are *subject to* disincentives and the nature of those disincentives. A clarifying paragraph could follow the objective in order to define in which circumstances the cash holdings would be *subject to* disincentives as defined in paragraph 28.

Difficulties in meeting the objective

34. Even after defining a clear scope and objective for the proposed amendment (see paragraphs 24–33), we still think there may be practical difficulties in meeting that objective, namely:

   (a) an entity may not be able to identify which portion (if any) of the cash is *subject to* disincentives, because the entity can have several options for how it will transfer cash across the group. For example, in terms of potential tax impacts on the repatriation of cash balances between group entities, an entity may have different options, with each option having a different tax impact.[4] It could be argued that in these instances it is impracticable to meet the proposed amendment.

   (b) for cash to be *subject to* disincentives (see paragraph 28(c)) the entity should have no ability to access the cash without triggering those disincentives. We think that determining when an entity has or does not have the ability to access the cash is subjective, because feedback indicated that the entity's options to access the cash are wide. This could result in the proposed amendment not being effective and never being applied, because entities could always claim that they have the ability to access the cash.

   (c) we understand that sometimes investors want the information resulting from the proposed amendment to conduct an analysis that presumes that cash and cash equivalents (and marketable securities) are *immediately available* to pay liabilities. Some would argue that this is not consistent with a going concern basis and ignores an entity's plans for how the cash

[4] One of the preparers pointed out that it would be very hard to provide this disclosure by analysing and assessing all of its thousands of subsidiaries.

and cash equivalents will be used thus requiring disclosures about potential effects that may never happen.

(d) finally, the proposed amendment relates only to the disclosures of cash and cash equivalents. Feedback from the ED has shown that the disincentives can also affect other liquid assets that are available to pay liabilities in addition to cash and cash equivalents (for example, marketable securities).[5] Consequently, the information regarding the cash and cash equivalent balances that are subject to disincentives would not include other liquid assets and this would result in an incomplete picture to investors.

35. In the light of such difficulties we recommend the IASB not to finalise the amendments at this project (ie IAS 7 amendments) because we think this topic could benefit from further steps and research.

Recommended next steps

36. We think the difficulties noted in paragraph 34(a)–(c) highlight that we need to consider further why investors are requesting this information. We think understanding why investors are requesting this information, in addition to expanding the scope of the proposals to address the difficulties described in paragraph 34(d), is a more substantive project than a narrow-focus amendment to IAS 7.

37. In addition, over the course of this project we identified that the proposed amendment is somewhat connected to other IFRS because it relates to topics such as liquidity (IFRS 7 and paragraph 50 of IAS 7), tax (IAS 12) and also to how capital is managed (paragraphs 134-136 of IAS 1). Although we think there is no overlap between the proposed amendment and those IFRS we think the proposed amendment would benefit from further analysis and research that would consider these requirements.

38. For these reasons we think the proposed amendment should not be finalised at this moment to be dealt with in a project of its own. We think such project could look at liquidity disclosures with a broader view including the related disclosures in IAS 7 (paragraph 50), IFRS 7 and IAS 1 (paragraphs 134-136). Furthermore, the project could also assess other suggestions provided by users in comment letters and outreach

[5] See paragraph 41(b) of Appendix A.

activities, including a suggestion briefly explained in Appendix C that was proposed by users as a complement or substitution to the proposed amendment.

39. For those reasons we recommend the IASB not to finalise the amendments at this time to conduct further research in a dedicated project that would look at liquidity more broadly and also consider users' suggestion in Appendix C.

Question 1 for the IASB
1. Does the IASB agrees with the staff recommendation in paragraph 39?

Feedback on the IFRS Taxonomy

Exposure Draft

40. The proposed paragraph 50A of IAS 7 requires 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.

41. In order to represent the latter part of the requirement 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 is a monetary type element, which means that the reported value should be numeric.

Feedback received

42. Some respondents responded to Question 3c. Of these respondents, 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 suggests 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

43. On the basis of the feedback received, the staff consider the requirement to be unclear. It might be interpreted as requiring either quantitative or qualitative information.

44. As the staff recommendation is not to finalise the proposed amendment to IAS 7 at this time, the comments received on the Taxonomy elements cannot be directly used. The comments received on the Taxonomy will be used if and when further research is conducted on the issues addressed by the proposals to ensure that any new proposals are clear in terms of the type of information (qualitative or quantitative) that is required to be reported.

Appendix A—Extracts from Agenda Paper 11A of the June 2015 IASB meeting

Question 1(b): Other disclosures

Introduction

36. The ED proposed to insert a paragraph (50A) into IAS 7 under the 'Other disclosures' section to extend the disclosures required by IAS 7 about an entity's liquidity. Specifically the proposals require disclosure about the 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.

Feedback

37. Almost all investors and regulators agreed with the proposed amendment. Most of the respondents echoed the benefits already set out in the Basis for Conclusions to the ED for their support and highlighted that the proposed amendment will:

   (a) assist investors in assessing costs or other implications that effectively restrict the use of cash and cash equivalent balances, in order to:

      (i) identify the true net debt position of an entity, confident that all the relevant liquidity constraints have been considered;

      (ii) enhance their understanding of the liquidity risk exposure of an entity;

      (iii) perform a single top-down assessment of liquidity for a group entity as a whole, which is more beneficial than being required to perform a number of bottom-up assessments of liquidity for each entity within the group individually;

      (iv) avoid having to make a number of adjustments (for example, applying a 'discount' to reported cash and cash equivalents) to financial statements to reflect an estimate of costs that may be associated with accessing funds; and

   (b) not cause significant additional costs or undue delay in the publication of financial statements, because the information required to produce this disclosure should be already available through the treasury function within an entity.

38. Most preparers and auditors disagreed with the proposed amendment and added that the IASB should work on this issue in a more comprehensive manner within the Principles of Disclosure project or other relevant project, in order to fully understand what information related to liquidity is of most use for investors. This would also avoid creating a patchwork of overlapping piecemeal disclosures, which reduces the decision-usefulness of the resultant information.

39. They added that the proposed amendment overlaps with multiple disclosure requirements on the liquidity position of a group, such as in:

    (a) paragraphs 34(a), 39 and B10A–B11F of IFRS 7;

    (b) paragraph 13(a) of IFRS 12 *Disclosure of Interests in Other Entities*;

    (c) paragraph 48 of IAS 7; and

    (d) paragraph 81(f) of IAS 12 *Income Taxes*.

40. Many respondents therefore requested that the IASB clarify the relationship between the disclosure requirements cited in paragraph 40 and the proposed paragraph 50A, or alternatively to consider extending the scope of one of those disclosures to include the current discussion on the proposed paragraph 50A. In their view, this would avoid any instances of duplication or overlap within the financial reporting package as a whole.

41. In addition, they suggested that in its current form, the proposed amendment:

    (a) does not clearly articulate the rationale or the objective of the proposed disclosure (including how the resulting information will enhance decision-making by users of financial statements). This could lead to the requirement being interpreted too broadly to include the disclosure of management's policies on the use of its own funds, for example, minimum cash floats or thresholds to ensure debt/equity ratios are maintained, which, in their view, does not fit with the purpose of general purpose financial statements;

(b) would result in some liquid financial assets that are not recognised as cash and cash equivalents (for example, marketable securities) but that are managed against an entity's debt being excluded from the proposed disclosure; and

(c) does not include some specific matters that are important to a review of an entity's liquidity position, such as the entity's ability to settle debt by issuing equity. For example, one respondent stated:

> We believe that investors would be interested in both aspects of funding (debt and equity), in order to better understand the gearing, liquidity and funding as a whole, of an entity. For example, in some jurisdictions, the ability for the entity to issue equity without further shareholders approvals may be an important component in the entity being able to settle its debt obligations. *South African Institute of Chartered Accountants (SAICA)*

42. Some preparers stated that it would be burdensome and costly to comply with the proposed disclosure on a consolidated group basis because:

(a) it may necessitate disclosure or consideration of a range of possible outcomes that are subject to complex tax planning events (for example, various intercompany transactions, restructurings, cash pooling etc.);

(b) it is based on hypothetical future events that are neither relevant nor practicable to take into consideration until such time that management has identified an actual need to access the 'restricted' funds; and

(c) it could be substantially costly for auditors to comprehensively examine the matters required to be disclosed.

43. Most of the standard-setters and accountancy bodies agreed with the proposed amendment. However, some of the respondents within these groups expressed similar concerns to the matters highlighted by the preparers, which are listed above in paragraphs 39 to 42.

44. A few respondents stated that the proposed amendment is geared towards presenting cash restrictions for cash and cash equivalent balances held at the end of the reporting

period and are therefore not relevant to investors within a forward-looking context. In these respondents' view, the current discussion on cash restrictions is better placed as an extension to the disclosure requirements in IFRS 7 for financial liabilities or liquidity risk management.

45. A few respondents suggested that the proposed amendment could be avoided or could result in a boilerplate disclosure if an entity admits to an existing legal restriction whereby tax liabilities would arise on repatriation , but claims:

(a) that it intends to retain cash and cash equivalent balances in an overseas entity to:

(i) maximise its returns on those balances; or

(ii) finance further investments within that particular jurisdiction.

(b) that, even though the individual company may be subject to restrictions, this does not affect the practice of the group as whole, because the group treasury management function ensures that all the individual companies can have access to the liquidity at all times.

46. A few respondents requested additional clarifications regarding the meaning of 'matters relevant to an understanding of the liquidity of the entity' and whether such 'matters' should be disclosed qualitatively or quantitatively. Those respondents cited that although the proposed paragraph 50A could be read as requiring only qualitative disclosures, the proposed change to the IFRS Taxonomy suggests that such disclosures would be quantitative (see paragraph 56).

47. A few respondents also made the following suggestions regarding the proposed paragraph 50A, namely that the amendment:

(a) should not include examples of restrictions, which could lead the requirement to be interpreted too narrowly and to be read within the sole context of requiring tax liabilities that would be incurred upon repatriation;

(b) should provide a few more examples (for example, cash and cash equivalent balances held in escrow accounts) to enhance the understanding of the objective of the proposed amendment;

(c) should include a disclosure (preferably a table) that would show the dispersion of a group’s cash and cash equivalent balances, as well as debt among the relevant geographical locations along with the currency denominations of those balances;

(d) would be better placed for discussion under the operating and financial review within the management commentary; or

(e) be incorporated by cross-referencing to existing disclosure requirements (prudential and accounting) that are already provided outside of the financial statements (for example, Basel Pillar 3 disclosure requirements).

Appendix B—Extract of financial statement containing disclosures in accordance with the current paragraph 48 of IAS 7, which uses the word ‘restriction’

23. Cash and cash equivalents

		$ million
	2014	2013
Cash at bank and in hand	**5,112**	6,907
Term bank deposits	**18,392**	12,246
Cash equivalents	**6,259**	3,367
	29,763	22,520

Cash and cash equivalents comprise cash in hand; current balances with banks and similar institutions; term deposits of three months or less with banks and similar institutions; money market funds and commercial paper. The carrying amounts of cash at bank and in hand and term bank deposits approximate their fair values. Substantially all of the other cash equivalents are categorized within level 1 of the fair value hierarchy.

Cash and cash equivalents at 31 December 2014 includes $2,264 million (2013 $1,626 million) $\boxed{\text{that is restricted. The restricted}}$ cash balances include amounts required to cover initial margin on trading exchanges and certain cash balances which are subject to exchange controls.

Appendix C—An alternative proposed by investors

A1. Most investors constantly requested additional information to complement the proposed amendment. This same suggestion was identified in the Capital Markets Advisory Committee meetings and also in the comment letters from investors as well as in some outreach activities conducted with local investor groups.

A2. Investors have suggested this additional disclosure to complement the proposed amendment so as to help them in understanding the potential effects of moving cash across the group (and across the world) or returning it to shareholders.

A3. The suggestion is to require the disclosure of a table that shows cash and cash equivalents segregated by currency or country in order to enable investors to understand legal, political, tax and foreign currency risks on cash balances within an entity's group liquidity. Some investors also suggested including the same table for an entity's debt dispersion, to be looked at together with the cash table. Some entities already provide this table for cash and cash equivalents by currency in the following way:

	2014 £'000
Sterling	30,669
Euro	2,586
Australian Dollars	2,287
New Zealand Dollars	344
Norwegian Krone	610
US Dollars	1,631
Other currencies	550
Total	38,677