STAFF PAPER

April 2016

IASB Meeting

Project	Disclosure Initiative		
Paper topic	Disclosures about restrictions on cash and about liquidity		
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Purpose of this paper

1. In December 2014 the Board published an Exposure Draft *Disclosure Initiative—Amendments to IAS 7* ('the Exposure Draft') which included proposals for the disclosure of:

   (a) a reconciliation of liabilities whose cash flows were, or future cash flows will be, classified as financing activities in the Statement of Cash Flows ('the reconciliation'); and

   (b) restrictions that affect the decisions of an entity to use cash and cash equivalents ('the cash restrictions proposals').

2. In October 2015, as a result of comments received on the Exposure Draft, the Board decided to:

   (a) finalise the reconciliation as a stand-alone amendment to IAS 7. This amendment was issued in January 2016;

   (b) further test with preparers the cash restrictions proposals presented in paragraph 19 of Agenda paper 11B from the October 2015 meeting;[1] and

[1] We have not yet conducted any testing with preparers.

(c) assess, after analysing the feedback from the 2015 Agenda Consultation, whether the cash restrictions proposals should be included in a potential liquidity disclosures project.

3. The purpose of this paper is to provide information to enable the Board to decide at a future meeting whether to:

(a) continue with the proposals on cash restrictions as a stand-alone project;

(b) add a broader scope project to the Board's agenda to address investors' requests for liquidity disclosures (including restrictions on cash). This work could be carried out as a stand-alone project or as part of the Primary Financial Statements research project; or

(c) discontinue work on the cash restrictions proposals.

4. We are not seeking any decisions from the Board at this meeting.

Structure of the paper

5. This paper summarises:

(a) The Exposure Draft feedback on cash restrictions (paragraphs 6-14);

(b) The 2015 Agenda Consultation feedback on liquidity and cash restrictions (paragraphs 15-21);

(c) FASB proposals on liquidity risk disclosures (paragraphs 22-25); and

(d) Staff analysis (paragraphs 26-28).

Exposure Draft feedback on cash restrictions

6. 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.

7. Paragraphs 36-47 of Agenda Paper 11A for the June 2015 Board meeting summarises the comments received on the cash restrictions proposals in the Exposure Draft. The following table describes the demographic information of respondents:

Entity type	Proportion
Investors	**10%**
Preparers	**32%**
Standard-setting bodies	**23%**
Accountancy bodies	**16%**
Accounting firms	**9%**
Regulators	**5%**
Others	**5%**

8. Almost all investors and regulators who commented on these proposals agreed with the cash restrictions proposals as did most of the standard-setters and accountancy bodies.

9. Investors highlighted that the proposed amendment would assist investors in identifying factors (such as cost) that restrict the use of cash and cash equivalent balances. Such information could be used to help:

   (a) identify the true net debt position of an entity; and

   (b) enhance their understanding of the liquidity risk exposure of an entity.

10. A few investors also supported the proposed amendment because in their view it would supplement existing requirements on cash balances in paragraph 48 of IAS 7, which requires the disclosure of cash and cash equivalent balances held that are not available for use by the group. One investor noted that currently investors apply to

reported cash and cash equivalent balances a discount that reflects an estimated cost of repatriating funds.

11. A few investors suggested that the Board should consider further disclosures about an entity’s cash balances:

    (a) two investors suggested that a table showing cash and cash equivalent balances and debt balances dispersed by countries and/or currencies would provide useful information, because it would enable investors to understand the legal, political, tax and foreign currency risks which are likely to have implications for the liquidity of the group; and

    (b) one investor stated that they also require information about liquid investments other than cash and cash equivalents for their analysis.

12. Most preparers and accounting firms disagreed with the proposals:

    (a) Some preparers raised concerns about the usefulness of the proposals. These preparers stated that the proposed disclosures could be misleading, particularly if restricted cash balances are in fact available to repay liabilities that are in the same place as the cash;

    (b) Many were of the view that the IASB should address this issue more comprehensively within the Principles of Disclosure project or other relevant project, in order to fully understand what information investors require about liquidity;

    (c) Some suggested that the amendments should be deferred until after the Principles of Disclosure project is finished so that new disclosures are not added before disclosure principles are developed;

    (d) Many expressed the view that the wording of the proposals was confusing.

13. A few constituents believe that the cash restrictions proposals are better placed as an extension to the disclosure requirements in IFRS 7 *Financial Instruments Disclosures*.

14. In February 2016, the staff provided members of the Capital Markets Advisory Committee (CMAC) with an update on the finalisation of the amendments to IAS 7. Some members of CMAC requested that the Board continue to pursue the proposed cash restrictions disclosure. One CMAC member suggested that, before moving

ahead with the proposals, the staff should discuss with CMAC what information investors need about cash restrictions.

2015 Agenda Consultation feedback on liquidity and cash restrictions

15. There was no specific question or mention about cash restrictions or liquidity disclosures in the 2015 Agenda Consultation. Nonetheless, some investor groups commented on the need for more disclosures about liquidity.

16. Three investor groups requested information about how much cash and cash equivalent balances are freely available to be used by the parent company at the reporting date and about the existence of potential restrictions on the transfer of cash and cash equivalent balances.

17. These investor groups described the following examples of factors that could restrict the ability of an entity to transfer cash between group entities:

    (a) taxes;

    (b) dividend leakage to non-controlling interests in subsidiaries; and

    (c) covenants that would penalise cash transfers from a subsidiary (eg a covenant based on a cash ratio).

18. One investor group stated that, to help assess an entity's liquidity, further information about the capital structure of the entity is needed. This group suggested a number of disclosures about financial debt, including:

    (a) an aggregate overview of nominal debt maturities per annum;

    (b) a reconciliation between the aggregate nominal amount and the aggregate carrying amount of debt in the statement of financial position;

    (c) information about where in the group structure the debt resides;

    (d) the entity's hedging policy for debt; and

    (e) information about assets pledged to providers of capital.

19. Another investor group stated that they need more information to help them understand management's plans for servicing existing debt and the risks associated with this. They also suggested requiring:

    (a) a more detailed maturity analysis of debt rather than the maturity analysis suggested in an example in IFRS 7;

    (b) information that enables investors to tie the numbers in maturity schedules to the numbers in the balance sheet by showing principal and interest payments separately, and reconciling total gross payments to the balance sheet (ie showing adjustments for discounting, fair value hedge adjustments, fair value option adjustments etc.); and

    (c) additional information about the entity's principal covenants, such as their terms and any restrictions in place.

20. One other investor group suggested that the disclosure of average and peak debt during the financial year would provide useful information.

21. Additionally, in response to the Online Survey conducted as part of the 2015 Agenda Consultation, a few investors suggested that more disclosures on financial debt and liquidity are needed, including:[2]

    (a) a definition of financial debt;

    (b) information about covenants, actual performance on covenants and encumbered assets;

    (c) a net debt reconciliation, as a next step for the already finalised *amendments to IAS 7* (which suggests a 'gross debt' reconciliation).

[2] The staff viewed an online survey that included the same topics as the 2015 Agenda Consultation as a complimentary way of obtaining feedback from a broad range of investors and analysts. The online survey included a 'free form' question which asked respondents to list up to three financial reporting topics, however big or small, on which they would like the Board to focus. See Agenda Paper 24C at this meeting for more information about the online survey.

FASB proposals on liquidity risk disclosures

22. In 2012 the FASB issued a Proposed Accounting Standards Update on *Financial Instruments (Topic 825): Disclosures about Liquidity Risk and Interest Rate Risks* (the FASB ED). These proposals included the following disclosures:

	Liquidity risk	Interest rate risk
Financial Institutions	• Liquidity gap maturity analysis • Available liquid funds • Issuance of time deposits (Depositary institutions only)	• Repricing gap analysis • Interest rate sensitivity analysis
Nonfinancial institutions	• Cash flow obligations • Available liquid funds	• Not applicable

23. The FASB ED included the following table as an example of how an entity could fulfil the proposed disclosure requirements about the entity's available liquid funds:

	Parent Company	Subsidiaries	Broker / Dealers
Available liquid funds:			
Cash	$X,XXX	$X,XXX	$X,XXX
Deposits (interest-bearing and non-interest-bearing)	X,XXX	X,XXX	X,XXX
Government-issued debt securities	X,XXX	X,XXX	X,XXX
Public sector debt securities	X,XXX	X,XXX	X,XXX
Availability of borrowings:			
Amount available under ABC credit facility	X,XXX	X,XXX	X,XXX
Amount available under receivables purchase agreement	X,XXX	X,XXX	X,XXX
Amount available under XYZ credit facilities	X,XXX	X,XXX	X,XXX
Total available funds	$X,XXX	$X,XXX	$ X,XXX

24. In addition to this table, the FASB ED proposed that an entity should disclose the following narrative information about the transferability of funds between entities:

> In disclosing its available liquid funds, an entity shall include a narrative discussion about the effect of regulatory, tax, legal, repatriation, and other conditions that **could limit the transferability of funds among entities**. This disclosure shall include quantitative amounts related to funds subject to those conditions, if applicable. [emphasis added]

25. The Proposed Accounting Standards Update was not finalised. We understand that the FASB has no plans to finalise it. We note that the FASB has recently decided to develop requirements for not-for-profit entities to disclose information that is intended to be useful in assessing their liquidity.[3]

Staff analysis

26. After further analysing the investor feedback received and conducting further research we think we know what investors need on this topic. We think investors want to understand how much cash, cash equivalents and other liquid assets are available at the reporting date for an entity to use, for two different purposes:

    (a) to meet the financing needs of the group (we think that information about this enables investors to calculate a more accurate net debt position); and

    (b) to be freely used in the whole group by management for strategic purposes such as merger and acquisitions activity and capital management activity (eg share buybacks, dividends and special dividends).

27. We learned that if there are restrictions on the ability of an entity to move liquid resources between group entities, investors want a better understanding of those restrictions. Currently investors commonly discount (haircut) an entity's cash and cash equivalent balances by a fixed rate when calculating a net debt position. They apply a fixed rate because they do not have enough information to arrive at a more accurate figure. For example, Standard and Poor's corporate methodology to adjust financial data states the following:[4]

> If available information indicates a greater or lesser accessibility to cash and liquid investments, the haircut would be raised or lowered. For example, the haircut would increase if a company holds a large proportion of cash abroad in a nonconvertible currency, or if the marginal tax payable on

[3] See the FASB 2 March 2016 Tentative Board Decisions To Date.

[4] This text is quoted from paragraph 236 of Standard and Poor's *Corporate Methodology: Ratios And Adjustments* which was submitted to us in their comment letter to the Exposure Draft. Such report includes the criteria used by Standard and Poor's for making analytical adjustments to nonfinancial companies' financial data.

> repatriation would exceed 25%. On the other hand, the haircut percentage would be lowered if, for example, detailed analysis showed that the amount of cash and liquid investments accessible on short notice would be higher than our standard assumption, or if any tax payable on repatriation of cash and liquid investments would be at a rate of less than 25% and we believed that no other factors make the cash and liquid investments inaccessible.

28. The Standard and Poor's guidance covers both situations (ie when an entity cannot access to the cash because it is trapped abroad and when it can access the cash but it will have to pay cash (eg through taxes) to access it).