Financial Reporting Council

July 2017

Feedback Statement

Discussion Paper Improving the Statement of Cash Flows

The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

The Financial Reporting Council Limited is a company limited by guarantee.
Registered in England number 2486368. Registered Office:
8th Floor, 125 London Wall, London EC2Y 5AS

Contents

Introduction and overview

(i) The Discussion Paper *Improving the Statement of Cash Flows* was published by the FRC in October 2016. Its purpose was to stimulate debate on opportunities to make the statement of cash flows more useful. This would provide input to the IASB's project on *Primary Financial Statements.*

(ii) Responses were requested by 31 March 2017. The FRC received 22 comment letters, including three from national standard-setters and four from groups representing users. A third of respondents were from Europe. The Appendix provides a summary of respondents by background and geography.

(iii) This Feedback Statement provides an overview of the responses. The Discussion Paper and the responses can be obtained from https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/Discussion-Paper-Improving-the-Statement-of-Cash.aspx

General views

(iv) A large majority of respondents welcome the publication of the Discussion Paper or agree with most or some of its suggestions. A representative group of users said:

We welcome the FRC's detailed review of the cash flow statement as it has been a long neglected financial statement from a standard setting point of view despite the information contained within it being integral for assessing the liquidity, working capital management, and quality of earnings reported by companies.

(v) Three responses from groups that represented users said that they hope the feedback from this Discussion Paper will be incorporated into the IASB's project on *Primary Financial Statements.* However, one accountancy firm said that, while the Discussion Paper is a positive contribution to debate, they are not convinced that there is sufficient clarity about the needs of users to propose particular changes at this stage as they suspect there is a diversity of needs. Accordingly, that firm recommend further interaction with users to better understand what changes would improve the relevance of the statement of cash flows.

High-level messages

(vi) In summary, the main messages from respondents on each section of the Discussion Paper can be summarised as follows:

1 **The usefulness of information about cash flows**—Some respondents agree that the main purpose of a statement of cash flows is to assist users to assess liquidity and the financial structure of the entity and changes in these. A large majority of respondents agree that notional cash flows should not be reported in the statement of cash flows although there should be disclosure of non-cash transactions.

2 **The classification of cash flows**—A majority of respondents agree that operating activities be positively defined or described. There are split views as to whether or not capital expenditure should be reported within operating activities rather than as an investing activity. The majority of respondents consider that all cash flows relating to financing liabilities should be reported in the financing category of the statement of cash flows. A majority of respondents agree that tax should be in a separate section of the statement of cash flows.

3 **Cash equivalents and management of liquid resources—**There are split views as to whether or not the statement of cash flows should report flows of cash or of cash and cash equivalents. Some respondents agree that net presentation of cash flows (other than those in respect of operating activities) should be permitted only for cash flows relating to financial instruments that are of the same class.

4 **Reconciliation of operating activities**—A majority of respondents agree that a reconciliation of operating activities should be presented in all cases.

5 **Direct or indirect method**—A large majority of respondents agree that the direct method statement of cash flows should continue to be permitted.

(vii) The following sections provide more granular information about the responses to the specific questions on which the Discussion Paper invited views.

(viii) The Discussion Paper presented suggestions to stimulate debate (which were not official positions of the FRC) and to provide input to the IASB. As the Discussion Paper provided a rationale for its suggestions, this Feedback Statement places more emphasis on the points made by respondents that disagreed rather than those that agreed.

(ix) The FRC will continue to monitor IASB's work on cash flow reporting, but does not plan any initiatives of its own at this stage. Accordingly, this Feedback Statement does not include the FRC's own views but simply reports the views of respondents.

Responses to specific questions

The usefulness of information about cash flows

1 Section 1 of the Discussion Paper reviewed the possible objectives of information about cash flows, and concluded that the main purpose of such information is to assist users to assess liquidity, and the financial structure of the entity and changes in it. It suggested that this requires information on where the cash has come from and where it has gone. Consistent with this, it suggested that notional cash flows should not be reported in the statement of cash flows. However, transparent disclosure of non-cash transactions should be required.

Question 1

Do you have any comments on the discussion of the usefulness of information about cash flows?

	No. of respondents
Agreed that the objective of cash flow information is to assist users to assess liquidity, and the financial structure of the entity and changes in it	7
Agreed that the objective of cash flow information is to assist users to assess liquidity but did not agree that it assists assessment of financial structure of the entity and changes in it	3
Not clear	8
Disagreed	2
	20
No response to this question	2
	22

2 Some respondents (from different types of organisation) explicitly agree that the main purpose of a statement of cash flows is to assist users to assess liquidity and the financial structure of the entity and changes in these. Three accounting firms agreed that the purpose is to assess liquidity. One user representative group suggested that "…for most companies the use of the cash flow statement to highlight liquidity is of only marginal value as most analysts tend to focus on "net debt" and the maturity profile of financial liabilities."

3 A representative body of preparers noted that cash flow information is important for the preparing entities themselves. While they agreed that from an external perspective its main purpose is to provide information about liquidity and financial structure and the changes therein, they added that another important aspect is that the cash flow often forms the basis for valuation of entities in various circumstances, for example in evaluating potential acquisitions.

4 Two respondents disagree with the main purpose of the statement of cash flows as set out in the Discussion Paper. A group representing users said:

We strongly believe that most of them [users] *actually use cash flow information to complement other financial statement information. In particular, we believe that most users use it to complement the income statement, i.e. performance reporting (e.g. assess the ability of a company to generate cash flows from its operations while being able to invest).*

A national standard-setter said:

In our view, the statement of cash flows derives from a stewardship purpose by depicting how the management generated inflows of cash and equivalents of cash and how it used those liquid resources during the reporting period. In this way it helps to better understand the performance of the entity as it allows for assessing the quality of reported earnings. Certainly, this cash flow information can also be of help in the context of other financial assessments, e.g. to gain more insights about the entity's liquidity and to support prediction efforts regarding the projection of future cash flows of the entity. Nonetheless, we do not think that a statement depicting historical cash flows has its main objective in providing information to whether the entity is likely to generate sufficient future cash inflows to meet its liabilities as they fall due. Similarly, we think that the capability of the statement of cash flows to provide insights to the financial structure of the entity is limited and should not be considered as the second main objective.

5 Other respondents disagree with the assertion that the statement of cash flows does not provide a measure of performance, highlighting the importance that investors and analysts attach to 'free cash flow'. Some suggest further outreach to determine what could be done to improve the reporting of this measure.

Question 2

Do you agree that notional cash flows should not be reported in the statement of cash flows, but that non-cash transactions should be transparently disclosed? If notional cash flows should, in your view, be reported, how would they be identified?

	No. of respondents
Agreed	16
Not clear	2
Disagreed	1
	19
No response to this question	3
	22

6 A large majority of respondents agree that notional cash flows should not be reported in the statement of cash flows, but that non-cash transactions should be transparently disclosed. An accountancy body commented that "Non-cash investing and financing activities are as important [as cash transactions] for the users of financial statements

because they may have a significant impact on the current and future performance in terms of revenues, profits and the ability of the entity to generate positive cash flows." They go on to suggest that the requirement to disclose significant non-cash investing and financing transactions as required by paragraphs 43 and 44 of IAS 7 should be extended to operating activities because the "management of working capital is of significant importance". Several other respondents make this suggestion. Conversely, a group representing preparers said that changes to IFRS disclosures are not necessary as they are required by other standards such as paragraph B64 of IFRS 3 (relating to changes to the entity's structure) that meet users' needs.

7 A few respondents note that a prohibition on reporting notional cash flows can give rise to classification problems. They suggest, for example, that the capital element of lease payments should be classified as an operating, rather than a financing, cash outflow, and note that similar issues arise in connection with factoring.

The classification of cash flows

8 Section 2 of the Discussion Paper included the following suggestions.

(i) Operating activities should be positively defined or described rather than being a residual or default classification. Items should not be excluded from operating activities merely because they are unusual or non-recurring.

(ii) Cash outflows to acquire property, plant and equipment should be reported as a cash outflow from operating activities. A sub-total of cash generated from operating activities before capital expenditure should be disclosed. Entities should be encouraged to disclose the extent to which expenditure on property, plant and equipment represents 'replacement' or 'expansion'.

(iii) Cash flows on financing liabilities (including the payment of interest) should be reported in the financing category of the cash flow statement. Cash received from customers (including any amount treated as interest income in the statement of profit or loss) should be reported within cash flow from operating activities.

(iv) Cash flows relating to tax should be reported in a separate section.

Question 3

Do you agree that operating activities should be positively defined or described?

	No. of respondents
Agreed	16
Disagreed	2
Not clear	1
Had other suggestions	2
	21
No response to this question	1
	22

9 A majority of respondents support the suggestion that operating activities should be positively defined or described and a few respondents acknowledged that this would be difficult. Points made by those that disagreed included:

- it would be more useful to develop a more structured approach regarding the classification of cash inflows and outflows; and
- there are no significant problems for users resulting from the absence of a positive definition of operating activities.

10 Almost half of respondents noted that if a positive definition is developed it needs to be consistent with the definition of operating activities used for the income statement. An accounting firm explained that "…it is important that the two statements reflect a consistent presentation of performance that then allows genuine disparities between cash and profit performance to be identified and explained."

Question 4

Do you agree that capital expenditure should be reported within operating activities rather than as an investing activity, with a sub-total drawn before capital expenditure, and disclosure of the extent to which capital expenditure represents 'replacement' or 'expansion'?

	No. of respondents
Agreed that capital expenditure should be reported within operating activities	7
Disagree that capital expenditure should be reported within operating activities	8
Not clear	4
	19
No response to this question	3
	22

11 The responses to the suggestion that capital expenditure should be reported within operating activities were split almost equally, with slightly more disagreeing compared to those agreeing. Points made by respondents who disagree include the following.

(i) This change in classification will not result in more relevant and reliable information.

(ii) Capital expenditure is an investment activity.

(iii) The benefit of this change may not warrant a change to current practice.

12 A few respondents expressed reservations about the consequences of this change, especially as to the treatment of "inflows or outflows of cash arising from strategic shareholdings", and what would be the content and purpose of the remaining investing activities section.

13 The majority of respondents do not consider that disclosure should be required of the extent to which capital expenditure represents ‘replacement’ or ‘expansion’, although some respondents consider that disclosure of this could be encouraged. The most frequent reason given for was that the division would necessitate too many arbitrary judgements to be useful.

Question 5
What are your views on the reporting of cash flows relating to financing liabilities?

	No. of respondents
Agreed that all cash flows on financing liabilities should be in financing section	11
Disagreed	3
Not clear	4
	18
No response to this question	4
	22

14 The majority of respondents consider that all cash flows relating to financing liabilities should be reported in the financing category of the statement of cash flows with a few suggesting that payments of interest should be presented separately from the repayment of principal. One respondent noted that the “the implementation of IFRS 16” will move “a substantial amount of cash flows … to financing activities resulting in a scenario where the operating activities exclude a cash flow that forms a core part of the business model”. Only a few respondents specifically stated that they agree that dividends paid should be classified as a financing cash flow.

15 An accounting firm supported the Discussion Paper’s analysis of the treatment of interest in the statement of cash flows. It said:

We are supportive of the view that the distinction between cash interest and principal is not necessarily beneficial in the cash flow statement, especially in scenarios where interest costs are imputed. This will become more prevalent with the adoption of IFRS 16 Leases as lessees start using amortised cost models for lease liabilities with the added impact of lease incentives such as rent free periods. This creates unneeded complexity when it is unclear from a cash perspective, the extent to which the repayment of a liability, or indeed receipt of cash, includes interest. The combination of the principal and interest in a single line within the applicable classification depending on the nature of the liability achieves the objective of demonstrating the relevant cash flows on financing liabilities.

Question 6

Do you agree that tax is best dealt with in a separate section of the statement of cash flows?

	No. of respondents
Agreed	12
Disagreed—only needs to be a separate line item	3
Not clear	4
	19
No response to this question	3
	22

16 A majority of respondents agree that tax is best dealt with in a separate section of the statement of cash flows.

Cash equivalents and the management of liquid resources

17 Section 3 of the Discussion Paper included the following suggestions.

(i) The statement of cash flows should report inflows and outflows of cash, rather than cash and cash equivalents.

(ii) A separate section of the statement of cash flows should report cash flows relating to the management of liquid resources. Liquid resources should be limited to assets that are readily convertible into cash, but should otherwise not be restrictively defined.

(iii) Entities should be required to disclose their policy for the management of liquid resources, and the classes of instruments that are treated as such.

(iv) Net presentation of cash flows (other than those in respect of operating activities) should be permitted only for cash flows relating to financial instruments that are of the same class.

Question 7

In your view, should the statement of cash flows report flows of cash or of cash and cash equivalents? How, in your view, should cash and/or cash equivalents be defined, and why?

	No. of respondents
Should report cash only	8
Should report cash and cash equivalents	6
Not clear	5
	19
No response to this question	3
	22

18 The responses to this question were split almost equally with slightly more preferring to change to reporting cash only compared to those wanting to keep cash and cash equivalents. A number of respondents who support retaining 'cash and cash equivalents' commented that there does not appear to be any significant issues with this approach in practice.

19 One standard-setter did not express a view as they consider that further clarification is necessary on whether there would be a new and broader definition of cash. They noted that that "it seems unclear how the DP suggestion would treat transactions with digital currencies, e.g. Bitcoin, that do not meet the definition of cash in IFRSs but become more and more popular in the digital age."

20 Only two respondents explicitly supported the proposal for a separate section in the statement of cash flows relating to the management of liquid resources and disclosure of the policy for the entity's management of liquid resources. One standard-setter would like to see further work done on the "disclosure of the management of liquid resources", but find it "difficult to support a proposal on the relatively loose description" in paragraphs 3.16–3.22.

Question 8

Which cash flows should, in your view, qualify for net presentation in the statement of cash flows?

	No. of respondents
Agreed that the net presentation of cash flows (other than those in respect of operating activities) should be permitted only for cash flows relating to financial instruments that are of the same class	7
Disagreed with this suggestion	1
Keep current requirements	4
Not clear	5
	17
No response to this question	5
	22

21 Respondents expressed a variety of views on the net presentation of cash flows, with some respondents agreeing with the Discussion Paper's suggestion that net presentation of cash flows (other than those in respect of operating activities) should be permitted only for cash flows relating to financial instruments that are of the same class. Two of these respondents added that it would need to be clear what was meant by "class" of financial instrument. One accounting firm asked whether "those instruments should be with the same counterparty as IFRS 7 does not go this far." One respondent disagreed with this suggestion as it would permit a very high degree of aggregation.

22 A few respondents wish to keep the current requirements as they consider that few problems are experienced with the current approach. A few respondents did not express a clear view.

Reconciliation of operating activities

23 Section 4 of the Discussion Paper included the following suggestions.

(i) A reconciliation of profit and cash flow should be presented in all cases (including where a direct method cash flow statement is presented). The reconciliation should be required to reconcile a sub-total in the statement of profit or loss that represents operating income (rather than, for example, net profit or loss) and reconcile that to cash flow from operating activities.

(ii) Because the amounts reported in the reconciliation are not cash flows, the reconciliation should not be reported within the statement of cash flows itself, but as a supplementary note, perhaps immediately following the statement of cash flows.

Question 9

In your view, is it appropriate to require the presentation of a reconciliation of operating activities in all cases, and to prohibit presenting it within the statement of cash flows?

	No. of respondents
Agreed	14
Not specifically mentioned	5
	19
No response to this question	3
	22

24 A majority of respondents agree that a reconciliation of operating activities should be presented in all cases. A couple of respondents commented that operating profit would need to be defined for this suggestion to be achievable.

25 A variety of views were expressed as to whether presentation of the reconciliation within the statement of cash flows should be prohibited, with some respondents preferring to keep the location optional. For example, a group representing users of financial statements expressed the view that the location is not important as long as it is readily found. Some respondents preferred a requirement to present reconciliation on the face of the statement of cash flows and a few respondents consider that it should be a separate note.

Direct or indirect method

26 Section 5 of the Discussion Paper included the following suggestions.

(i) It is not necessary for an accounting standard to require or permit a specific method for deriving ‘cash flow from operations’. As a reconciliation of profit and cash flow from operating activities is to be required, the indirect method is likely to be widely used in practice: however, the direct method should not be prohibited.

(ii) An accounting standard should identify components of cash flow from operating activities that are particularly significant, and require disclosure either of the amount of such components or of changes in related working capital items.

Question 10

Do you agree that the direct method statement of cash flows should be neither prohibited nor required?

	No. of respondents
Agreed	14
Disagreed, direct method should be prohibited	3
Disagreed, direct method should be a requirement	1
Not clear	1
	19
No response to this question	3
	22

27 A large majority of respondents agree that the direct method should continue to be permitted. A few respondents consider that the direct method should be prohibited to enhance comparability between entities.

Question 11

Which components of cash flows from operating activities should an accounting standard identify as particularly significant, and why? How should standard-setters decide whether to require disclosure of the amount of such components or of changes in related working capital items?

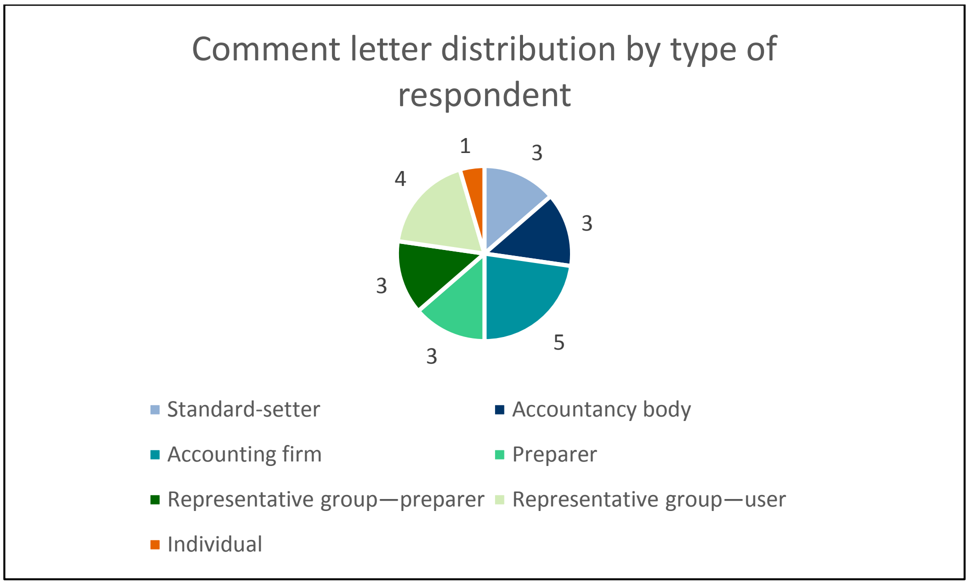
28 A variety of views were expressed in response to this question, which included the following.

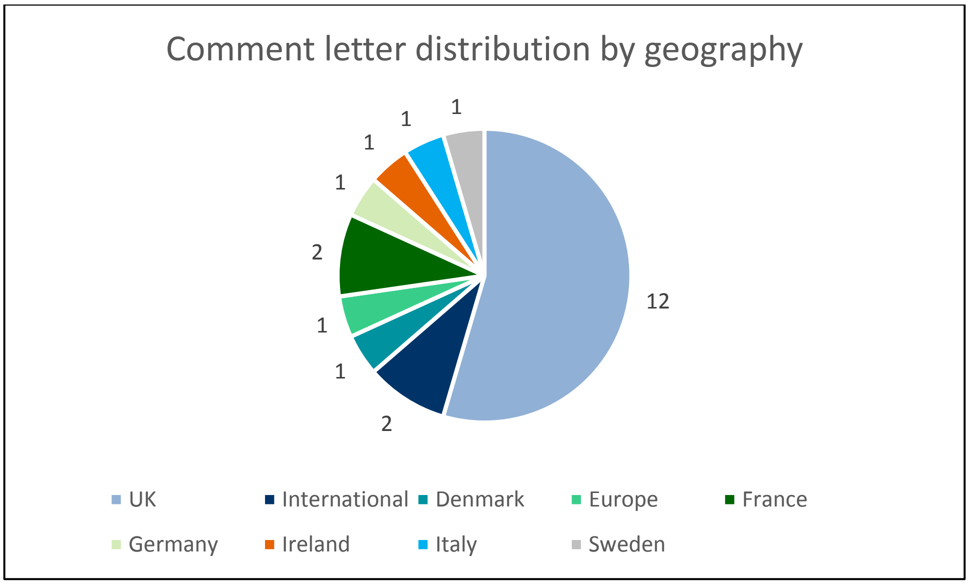
(i) Existing requirements are sufficient. Each entity should determine which components are material, significant or relevant in their own circumstances.

(ii) Further outreach is required to determine which components users would like to see disclosed and to judge the appropriate balance between costs and benefits.

29 Only a few respondents identified specific items that they consider should be required. One standard-setter expressed the view that movements in trade debtors, trade creditors, inventories, depreciation, amortisation and impairments plus other movements in working capital should be presented and disclosure of payments from customers and to suppliers should not be required.

* * * * *


Comment letter distribution by type of respondent
1
3
4
3
3
3
5
Standard-setter
Accountancy body
Accounting firm
Preparer
Representative group—preparer
Representative group—user
Individual


Comment letter distribution by geography
1
1
1
1
2
1
1
2
12
UK
International
Denmark
Europe
France
Germany
Ireland
Italy
Sweden

Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

+44 (0)20 7492 2300

www.frc.org.uk