STAFF PAPER

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IASB® meeting

Project	**Primary Financial Statements**
Paper topic	Feedback summary—Statement of cash flows

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Objective

1. This paper analyses feedback from comment letters and outreach on the proposals relating to the statement of cash flows set out in the Exposure Draft *General Presentation and Disclosures*. This paper also discusses fieldwork findings and a review of academic literature related to this topic.

Key messages

2. The key messages from the feedback on the proposals relating to the statement of cash flows are:
   (a) many respondents did not comment on the proposals;
   (b) of those respondents that did comment, many agreed with the proposals;
   (c) the main concern of those that did not agree was lack of alignment between the statement of cash flows and the statement of profit or loss, which was also raised as a concern by some fieldwork participants; and
   (d) some respondents requested a comprehensive review of IAS 7 *Statement of Cash Flows*.

Structure of the paper

3. This paper is structured as follows:

   (a) Proposals and questions in the Exposure Draft (paragraphs 4–0);

   (b) Comment letter and outreach feedback (paragraphs 7–19);

   (c) Fieldwork findings (paragraphs 20–29); and

   (d) Appendix A includes the relevant question in the Exposure Draft.

Proposals and questions in the Exposure Draft

4. The Board proposed requiring an entity to use the operating profit or loss subtotal as the starting point for the indirect method of reporting cash flows from operating activities.

5. The Board also proposed reducing the presentation alternatives currently permitted by IAS 7 and requiring that, in the statement of cash flows, an entity classifies interest and dividend cash flows as shown in Figure 1.

Figure 1—Classification of interest and dividend cash flows

<table>
<tr><th>Cash flow item</th><th>Most entities</th><th>Specified entities[1]</th></tr>
<tr><td>Interest paid</td><td>Financing</td><td rowspan="3">Accounting policy choice, possible location depends on the classification of the related income and expenses in the statement of profit or loss</td></tr>
<tr><td>Interest received</td><td>Investing</td></tr>
<tr><td>Dividends received</td><td>Investing</td></tr>
<tr><td>Dividends paid</td><td colspan="2">Financing</td></tr>
</table>

6. In the Exposure Draft package, the proposed amendment to paragraph 18(b) of IAS 7, proposed new paragraphs 33A and 34A–34D of IAS 7 and paragraphs BC185–BC208

[1] An entity that provides financing to customers as a main business activity or in the course of its main business activities invests in assets that generate a return individually and largely independently of the entity's other resources.

of the Basis for Conclusions describe the Board's reasons for the proposals and discusses approaches that were considered but rejected by the Board.

Comment letter and outreach feedback

Starting point for the indirect method of reporting operating cash flows

7. Many respondents did not comment on the proposal for the starting point of the indirect method of reporting operating cash flows.

Agreement

8. Of those respondents that did comment on this question, most, mainly from accountancy bodies and standard-setters, agreed with requiring operating profit to be the starting point. In particular, almost all users commented on this question and agreed with operating profit as the starting point.

9. Some of those that agreed with requiring operating profit as the starting point said that doing so would result in a consistent presentation that would enhance comparability between entities. Some also said that doing so would result in a more transparent link between operating cash flows and operating profit, and a shorter reconciliation between the two.

Concerns

10. Some respondents disagreed:

    (a) some said that useful information about non-operating non-cash flow items would be lost, for example fair value changes included in the investing and financing categories in the statement of profit or loss.

    (b) a few said that net profit was a more intuitive and understandable starting point.

    (c) a few said that the cost of changing the starting point would exceed the benefits. This was particularly the case for banks who said that they would expect to incur costs to modify their reporting systems but expect no benefits from the proposal.

(d) a few said that using operating profit as the starting point would cause confusion because of the lack of alignment between the definitions of operating for the statement of profit or loss and the statement of cash flows.

Alternative approaches

11. A few respondents suggested retaining the options over the starting point of the indirect method of reporting operating cash flows, to avoid entities having to incur costs of changing their method. These respondents said such costs would exceed any benefits of the proposals.

Classification of interest and dividend cash flows

12. Many respondents did not comment on the proposals for the classification of interest and dividend cash flows. Of those that did comment, many, mostly from Asia and Europe, agreed with the proposals but some disagreed.

Agreement

13. Many respondents, in particular most users, supported the removal of options for the classification of interest and dividends, saying that consistent presentation of such cash flows would enhance comparability.

14. Some respondents stated that the outcome of the proposals would often result in alignment of the presentation of interest and dividends in the statements of profit or loss and cash flows, and supported that outcome. In particular, a few respondents mostly preparers, explicitly said they expected entities that invest in the course of their main business activities to align the interest and dividend cash flow classifications in the statement of profit or loss and statement of cash flows.

Concerns

15. Almost all the concerns about the proposals related to a lack of full alignment of interest and dividend between the statement of profit or loss and the statement of cash flows (full feedback on alignment is in paragraphs 75–79 of Agenda Paper 21B—*Feedback summary—Subtotals and categories—general model*).

16. A few respondents expressed concern about the cost of the proposals:

(a) a few respondents said removing the options would impose a large burden on entities due to system changes required.

(b) a few respondents said the change in classification would exceed the benefits. This was particularly the case for banks, because they regard the statement of cash flows as providing little benefit.

Alternative suggestions

17. A few respondents, including some users, suggested a simpler approach to removing the options would be to require an entity to present all dividend and interest cash flows as operating cash flows. A few of these respondents also said that such approach would converge with US GAAP, which stipulates interest and dividend cash flows to be classified as operating.

18. Some respondents suggested greater alignment between the classification of interest and dividend cash flows and the presentation of the related income and expenses in the statement of profit or loss (see full discussion in Agenda Paper 21B).

Other comments on the statement of cash flows

19. Some respondents made other comments on the statement of cash flows:

(a) some, in particular many users, said the Board should undertake a comprehensive review of IAS 7, if necessary as a separate project. They say improvements are badly needed on topics including the alignment with the statements of profit or loss and financial position, how a statement of cash flows should be presented for entities that provide financial services, the definition of cash and cash equivalents and how to determine free cash flows.

(b) some entities that provide financial services asked to be allowed not to present a statement of cash flows, saying that such a statement does not provide useful information about their activities.

(c) a few respondents said that the direct method for determining operating cash flows should be required.

(d) a few respondents asked for guidance on how to present in the statement of cash flows amounts relating to specific items, including supply-chain arrangements (raised in particular by some users), reverse factoring, discontinued operations, and negative interest cash flows.

Fieldwork findings

20. The following section discusses the fieldwork findings related to the statement of cash flows. The findings are organised by the following categories corresponding to the objectives of the fieldwork:

(a) observations on how the requirements were applied;

(b) aspects of the Exposure Draft that participants identified as being unclear; and

(c) process or systems changes that may be required to apply the requirements.

21. The methodology of the fieldwork is described in Agenda Paper 21A—*Feedback summary—Overview*.

Observations on how the requirements were applied

22. Thirty-nine participants provided recast statement of cash flows, and thirty-seven changed the starting point for the indirect method reconciliation; most participants changed the classification of interest received or paid; twenty-five participants changed the classification of interest or dividends; and fourteen participants did not change. From those twenty-five participants who changed: twenty-two changed the classification of interest received or paid; fourteen changed the classification of dividend received; and one changed the classification of dividend paid.

Aspects of the Exposure Draft participants identified as unclear

23. Some participants classified in the operating category of the statement of profit or loss:

(a) income and expenses related to the provision of financing to customers; or

(b) income and expenses from investments made in the course of their main business activities.

24. A few of these participants were unclear on how to classify cash flows on interest paid and received in the statement of cash flows.

25. For example, one participant classified in the statement of profit and loss:

    (a) interest income on investments made in the course of their main business activities in the operating category; and

    (b) interest income on investments not made in the course of their main business activities in the investing category.

26. This participant questioned how to classify interest received in the statement of cash flows. Based on follow up discussions with the participant, the lack of clarity arose from the drafting of the guidance on how to classify interest paid or received in these circumstances.

27. One participant said they were unclear on how to present discontinued operations in the statement of cash flows. This participant proposed presenting operating profit from discontinued operations as a reconciling item immediately following operating profit in the indirect method reconciliation. The staff notes that IAS 7 is silent about the presentation of discounted operations in the statement of cash flows.

28. Some participants raised concerns that users of financial statements may be confused by the same titles but different definitions being used for the categories in the statement of profit or loss and the statement of cash flows. For example, one participant that does not provide finance to customers as a main business activity, was concerned that users could be misled by the fact that it presented a materially lower amount as cash from operations than its operating profit. The difference was caused by the classification of a material amount of interest income/receipts on receivables in the operating category of the statement of profit or loss but in the investing category in the statement of cash flows.

29. One participant that does not provide finance to customers raised a concern that reclassifying interest received on cash and cash equivalents from the operating category in the statement of profit or loss to the financing category in the statement of cash flows would decrease operating cash flows and negatively affect compliance with financial covenants in a loan agreement.

Question for the Board

Does the Board have any comments or questions on the feedback discussed in this paper? Specifically:

a) Is there any feedback or fieldwork evidence that is unclear?
b) Are there any points, or fieldwork evidence, you think the Board did not consider in developing the Exposure Draft but should consider in the re-deliberations?
c) Are there any points, or fieldwork evidence, you would like staff to research further for the re-deliberations?

Appendix A—Relevant questions in the Exposure Draft

Question 13—statement of cash flows
(a) The proposed amendment to paragraph 18(b) of IAS 7 would require operating profit or loss to be the starting point for the indirect method of reporting cash flows from operating activities. (b) The proposed new paragraphs 33A and 34A–34D of IAS 7 would specify the classification of interest and dividend cash flows. Paragraphs BC185–BC208 of the Basis for Conclusions describe the Board's reasons for the proposals and discusses approaches that were considered but rejected by the Board. Do you agree with the proposals? Why or why not? If not, what alternative approach would you suggest and why?