CPA IRELAND | CERTIFIED PUBLIC ACCOUNTANTS

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To whom it may concern,

The Institute of Certified Public Accountants in Ireland welcomes the opportunity to comment on:

The FRC Discussion Paper – Improving the Statement of Cash Flows

Question 1

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

We are broadly supportive of the proposed improvements, in particular we believe that enhancing the transparency of a company's cash flow information will help users to better understand the company's relative performance and increase the predictive value of cash flow results and can improve the usefulness of their cash flow information and enhance the understanding of their businesses by way of disclosing cash flow presentation policies and the location of specific transactions within the statement of cash flows.

Question 2

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

We agree that notional cash flows should not be reported in the statement of cash flows, but that non-cash transaction should be transparently disclosed.

The Statement of cash flows reports only those operating, investing and financing activities that affect cash or cash equivalents**.** Non-cash investing and financing activities are as important 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. IAS 7 require companies to disclose all significant non-cash investing and financing activities either at the bottom of the statement of cash flows as a footnote or in the notes to the financial statements

The Disclosure of notional cash flows relating to operating activities should be extended in the same manner as investing and financing activities as required by IAS 7 [para. 43 and 44] as the management of working capital is of significant importance.

Cash flows from operating activities are essential to assist users assess the company's ability to meet ongoing funding requirements, contribute to long-term projects and pay a dividend. Investors and users frequently use the non-cash working capital account when assessing the financial health of a business. Working capital tells the users how well companies are paying their short-term borrowings and how well they are collecting from customers and moving inventory and can reveal increases in efficiency in inventory turnover, more robust credit policy for customers, and an increase in efficiency in paying bills to short-term borrowers, such as suppliers.

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Question 3

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

We agree that operating activities should be positively defined or described, rather than being a residual or default classification. We agree with the omission of the reference in IAS 7's definition to 'and other activities that are not investing nor financing activities' and the expansion on 'the principal revenue-producing activities' of the entity to include transactions with customers, employees and suppliers.

Users will examine a company's cash flow from operating activities separately from the other two components of cash flow - investing and financing activities - to determine from where a company is really getting its money. Users want to see positive cash flow because of positive income from recurring operating activities. Positive cash flow that results from the company selling off all its assets, or because it has recently issued new stocks or bonds, results in one-time gains which is not an indicator of financial health.

Question 4

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

We do not agree that capital expenditure should be reported within operating activities rather than as an investing activity. As Capital Expenditure is reported on the Statement of Financial Position and presented as a material aggregated item with a disclosure note in accordance with the requirements of IAS 1, the Cash Flow statement will fill any gap by showing the users how much actual cash is generated or spent on investing activities.

Question 5

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

As IAS 7 does not offer a conclusive guidance on classification of interest and dividends paid and received, this will lead to a loss of comparability between entities regardless if they trade within the same sector and location. Financing activities are those activities that change the equity and borrowing composition of the company. This can include the cash proceeds received by the company for issuing additional shares or the proceeds received from the raising of a loan. In addition to funds received for issuing shares and raising loans.

IAS 7 [para. 31} states that Cash flows from interest and dividends received and paid shall each be disclosed separately. Each shall be classified in a consistent manner from period to period as operating, investing or financing activities.

This suggests that an entity shall not disclose the interest and dividends received and paid on net basis and that alternative options are given to an entity as to what section in the Statement of Cash Flows the interest and dividends paid are disclosed. The classification of these items in the statement of cash flows is that accountants and standard setters have raised different opinions e.g. it may be acceptable for Interest and dividends paid to be disclosed as operating activity as it is paid out of the profits generated by entity's operating activities. Conversely as interest is paid is a cost of obtaining financial resources, any interest paid can be disclosed as financing activity and dividends paid on ordinary shares are an appropriation of profits so it would be appropriate to disclose under financing activities. However, FRS 102 does permit an entity to classify dividends paid as a component of cash flows from operating activities on the grounds that they are paid out of operating cash flows.

For clarity IAS 7 should provide conclusive guidance on the classification of interest and dividends paid and received in a consistent manner.

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Question 6

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

We agree that tax is best dealt with in a separate section of the statement of cash flows and concur with the conclusion of the IASB's staff draft of the exposure draft "Financial Statement Presentation (Section 2 2.37).

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?

IAS 7 explains that cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. IAS 7 does not define 'short-term' but does state 'an investment **normally** qualifies as a cash equivalent only when it has a short maturity of, say, three-months or less from the date of acquisition' (IAS 7.7). Consequently, equity or other investments that do not have a maturity date are excluded from cash equivalents unless they are, in substance, cash equivalents This three-month time limit is somewhat arbitrary but is consistent with the concept of insignificant risk of changes in value and a purpose of meeting short-term cash commitments.

The definition of cash equivalents per IAS 7 is vague, and cannot reflect how all entities manage cash and liquid resources. In this context we are supportive that the statement of cash flows should report inflows and outflows of cash, rather than cash and cash equivalents, and that 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. Entities should also be required to disclose their policy for the management of liquid resources, and the classes of instruments that are treated as such.

Question 8

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

It should be required that IAS 7 further elaborates and provides conclusive guidance on which cash flows would qualify for net presentation. It would be appropriate for entities to include narratives in their accounting policies, highlighting the distinction between cash flows that are offset in the statement of cash flows. In addition, for those entities that operate in a range of different jurisdictions worldwide, it will be important for business entities to distinguish those countries in which bank overdrafts form part of the entity's cash management, and those where they do not.

IAS 7.13 – 17 sets out requirements for, and examples of, individual cash inflows and outflows that are to be presented separately in respect of operating, investing and financing activities. The offset of cash inflows and outflows is not permitted (except in limited circumstances for financial institutions)

IAS 7.8 further notes that although bank borrowings are generally considered to be financing activities, in some countries bank overdrafts form an integral part of an entity's cash management. In such cases, bank overdrafts are included as a component of cash and cash equivalents meaning that bank overdraft balances would be offset against any positive cash and cash equivalent balances for the purposes of the statement of cash flows.

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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?

We support that in the case where an entity presents a cash flow using the direct method, 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.

Where an indirect method cash flow statement is presented as the amounts reported in the reconciliation are not cash flows we support the conclusion that the reconciliation should not be reported within the statement of cash flows itself, but as a supplementary note, immediately following the statement of cash flows.

Question 10

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

We do not agree with this proposal and feel that the indirect method only should be required. Financial Statements should be as comparable as possible across entities. If only one method of presenting the Cash Flow Statement was permitted the capacity for the users of financial statements to compare one entity with another would be greatly enhanced. This would add to the transparency and usefulness of financial statements.

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?

As noted in Question 2, we support disclosure of the amount of such components or of changes in related working capital items.

If you have any questions on the above please do not hesitate to contact me.

Yours sincerely,

David Roxburgh
Chairperson, Financial Reporting Sub - Committee