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Cc: IASB, EFRAG

Stockholm February 15, 2017

Discussion Paper Improving the Statement of Cash Flows

Representing preparers' point of view, the Swedish Enterprise Accounting Group (SEAG) would like to express the following views concerning the Financial Reporting Councils (FRCs) Discussion Paper Improving the Statement of Cash Flows.

SEAG welcomes the FRC´s initiative to improve the usefulness of the statement of cash flows and the current disclosure requirements. We are generally very positive to the Discussion Paper and agree with most of the suggestions expressed therein. The statement of cash flows is in many cases a key to understand relationship between the external financial reporting and the management accounts. The ability of the cash flow statement to illustrate how the management of the reporting entity is reflected into the financial statements is thus an essential issue for our member companies.

Our comments to the specific questions posed in the Discussion Paper are provided in the appendix below. To further clarify our point of view, we have prepared an example that illustrates the alterations suggested by SEAG in comparison with the illustrative example of the FRC-model and the statement prepared in accordance with IAS 7 in appendix B of the discussion paper. The example is disclosed.

Yours sincerely,

CONFEDERATION OF SWEDISH ENTERPRISE

[redacted]

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The Swedish Enterprise Accounting Group (SEAG) represents more than 40 international industrial and commercial groups, most of them listed. The largest SEAG companies are active through sales or production in more than 100 countries.

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Appendix – Comments on the specific questions raised in the discussion paper

Question 1

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

- *The cash flow statement and the analysis thereof is important for investors and creditors but also for the preparing entities themselves.*
- *We agree that the main purpose from an external perspective is to provide information about liquidity and financial structure and the changes thereof.*
- *However, another important aspect is that the cash flow often form basis for valuation of entities in various circumstances. This could be, e.g., in evaluating potential acquisitions, preparing impairment tests, evaluating earn-outs. The methodologies for DCF valuations of entities is often based on free cash flow defined as EBITDA less calculated tax +/- change in working capital – capital expenditures. It should be noted that the calculations often disregard the current capital structure and therefore excludes interest paid and received (i.e. the cash payments related to the financial net result of the net debt). Common to most valuations are, hence, a wish to forecast EBITDA and sustainable levels of working capital and capital expenditures.*
- *From a preparer perspective cash flow analysis is often used internally to drive behavior and sound financial management by depicting the cash flow consequences of investments, capital turn over, payment terms etc. To some extent this could be labeled performance management as, e.g., cash conversion metrics complement the normal focus on sales growth and profit margins. However, we agree that performance measurement in the sense of replacing the income statement is not a primary focus for the preparation of the cash flow statement.*

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 included in the cash flow statement and that the logic of the indirect method should not be broken by making notional adjustments between various classes of cash flow to depict a cash flow as if the balance sheet items were classified in an alternative way.*

Question 3
Do you agree that operating activities should be positively defined or described?

Introductory comments regarding classification issues:

- *It is common for entities to have internal cash flow statements with a different layout than the "IFRS statement" and that the internal layout often follows the internal division of management responsibility.*
- *A common example is when a large corporation with many divisions divides the economic responsibility internally so that the divisions (or segments) have responsibility for net assets (operating assets less operating liabilities) and that a centralized treasury function manages the net financial debt.*
    - *It might be that this division is comprehensive and that Net assets = Net debt + Equity for the entity.*
    - *It might also be that net assets in fact are managed as two types of (net) assets. One type consisting of the net assets of the main operations and one type consisting of "investment type" assets so that Operating net assets + Investment net assets = Net debt + Equity. We believe that the classifications should support these models and the FRC proposals do so in our view.*
- *In the above model it would be natural to monitor the operating cash generation separately from the financing and interest paid and received. It would also be logical to separate taxes paid so that a true operating cash flow can be calculated that would complement the DuPont scheme (I.e. the model where return on net assets is explained by the product of capital turn-over ratio and profit margin).*
- *Furthermore, internal cash flow statements may be arranged as to sum up to the residual change in net debt as this would be the position that the central treasury function would have to manage.*
- *Based on these comments there is a clear need to modify the classifications in IAS 7.*

Comments on the specific question:

- *Yes we agree that operating activities should be positively defined or described. Our suggestion is to link the definition of operating cash flow to the entity's own definition of operating assets and liabilities (i.e. net assets) in line with our introductory comments.*
- *We also believe that investments in non-operating assets (e.g. share investments) and structural investments or divestments (i.e. acquisitions and divestments of entities) would be reported separately just as FRC proposes.*
- *We do not, however, agree that unusual operating items should be presented as a separate category as in the FRC example. We recommend keeping to a maximum of four categories i.e.*
    - *Cash flow from operating activities*
    - *Cash flow from investing activities*
    - *Income taxes paid (this category could potentially be located after financing)*
    - *Cash flow from financing activities*

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'?

- *Yes we agree that capital expenditures (operative investments in tangible and intangible assets) should be included within the operating activities according to the suggestion.*
- *We do not agree that disclosures of the extent to which capital expenditures represents replacement or expansion should be required. The reason is that it is very rare to be able to make a clear distinction between the two types. Replacements with newer technology mostly give rise to higher productivity and output so that the distinction between replacement and expansion becomes blurred.*

Question 5

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

- *We believe that the reporting of cash flows relating to financing liabilities should be excluded from the operating section and included in total in a financing section. Many entities manage its net debt position in a central function and cash and liquid funds are treated as a corporate assets rather than assets of the individual subsidiaries.*
- *Another reason (as stated in A1) is that the valuation of any entity is often done on a net debt free status. Consistently with this would be to keep cash flows related to the net debt in a separate section which would also include proceeds from share issues and the common dividend paid. Interest paid and received should be specified individually and not netted.*
- *Contrary to the FRC proposal (or maybe we misunderstand) we propose that interest received on cash included in the net debt position (and reported in the financial net) is included in the financing section.*

Question 6

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

- *Yes we agree for the same reasons mentioned in Q1 and Q3.*

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?

- *We believe that the cash definition that the cash flow statement reconciles to should have the same definition as the entity uses in its definition of net debt. Most entities now treat cash equivalents as "cash" and include it in the net debt definition and therefore we do not see any problem with keeping the current ending point of the cash flow statement.*
- *We also question the value of analyzing the cash flows from management of liquid resources. In our experience there is no focus on this from the investor community.*

Question 8
Which cash flows should, in your view, qualify for net presentation in the statement of cash flows?

- *We agree with the BC to FAS 95 that states that gross cash flows are not meaningful for investments with original maturities of a short nature (3 months or less). As preparers we experience few problems with this concept and prefer to keep the current requirements.*

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 have mixed views on this. For pedagogical reasons there may be a justification to show the reconciliations in the statement to cash flow as this may support the analysis and discussion. On the other hand the reconciliation items in the indirect method may be misinterpreted as commented in the FRC paper.*
- *However, EBITDA is often used both externally and internally so there may be a point in having the ingoing components of this measure immediately available in the cash flow statement. On balance we still think that the reconciliations should be included in the cash flow statement. An option would be to make the choice of presentation in the cash flow statement or in the disclosures voluntary.*

Question 10
Do you agree that the direct method statement of cash flows should be neither prohibited nor required?

- *Yes we agree. In our experience the indirect method is most common and in many cases the only option available unless the accounting and reporting set up allows for both a pure indirect method and the indirect direct method. Few entities are prepared to collect the information for a direct direct method from the records of cash payments. In any case there should be a choice for the entity.*

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?

- *Changes in working capital as recorded on the balance sheet are, in our view, not easily interpreted. The reality of a period specific cash flow is that it can easily be impacted by having single large payments on either side of the balance date. This is obviously a fact unrelated to the choice of the indirect or the direct method.*
- *In order to understand working capital movements it would be far better to require disclosure of 12 month rolling trends for e.g. receivables and payables in relation to sales and cost in order to illustrate the trends in working capital efficiency.*
- *However, we believe it should be left for the entity to judge what the key drivers of operating cash flow are and decide to present individual items.*