FRC
Mr Andrew Lennard
125 London Wall
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United Kingdom
by mail at cashflows@frc.org.uk

Paris, March 28, 2017

Dear Mr Lennard,

Re: Improving the statement of cash flows

We welcome the opportunity to answer to the request for comment on the FRC Staff paper that was issued in October 2016 “Improving the statement of cash flows”.

While we appreciate the paper’s discussion, we believe that the proposals do not resort only to incremental changes to the existing IAS (ref § IN4). In that respect, we believe a limited quick wins approach as contemplated by the IASB at the request of users will gain at the moment greater acceptability, as long as those quick wins do not participate in the loss of understandability of the various sections of the cash flows statement (as some recent decisions do or as the “concept” of financial statements cohesivesness may induce).

By providing our insights, we hope nevertheless to be helpful in the conduct of any future analysis of the purpose or evolution of the cash flows statement. A cash flows statement is indeed a key nonfinancial entities statement to both their investors and management alike.

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If you would like to discuss our comments further, please do not hesitate to contact us.

Yours sincerely,

/S/

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Improving the statement of cash flows
A Discussion Paper prepared by staff of the UK FRC
October 2016

1. The FRC is requesting comments by 28 February 2017 **(extended until 31 March 2017)**. cashflows@frc.org.uk
Comments are invited on all issues relating to possible improvements to the statement of cash flows. In particular, comments are sought on the questions below.

2. Comments are most helpful if they indicate the specific paragraphs to which they relate, contain a clear rationale and, where applicable, suggest an alternative approach.

Section 1 The usefulness of information about cash flows

3. This section reviews the purpose of providing information about cash flows. It concludes that the main purpose is to assist users to assess liquidity and the financial structure of the entity and changes in these.

4. It also suggests that notional cash flows should not be reported in the statement of cash flows, but that 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?

We disagree with the statement made in § 1.21 that "*it is [therefore] reasonable to be wary of the idea that a man focus of improvements to information about cash flows is to provide a measure of performance*" as per §1.20 that "*accruals information provides superior information on performance than information about cash flows; at least in the opinion of some, the best measure of free cash flow can be derived from accruals information; cash flow information cannot be considered as a measure of performance as it includes both returns on and returns of investments*".

The first statement in §1.20 would require that performance is defined, something that one has yet to be able to read about.

In our opinion, there is not a single approach to performance as in fact there are various activities in an organization and their performance cannot always be assessed through one type of statement (ie the statement of comprehensive income) or a single measure (the net result or the comprehensive income). Only understanding the various activities and their contribution may help appropriately define the expectations from the various financial statements.

This naturally requires more discussions about the various types of industries and the fact that no one size fits all set of financial statements is achievable, as this is amply demonstrated about the non-relevance of cash flow statements for financial institutions, the discussion about the distinction between operations and finance or about the evolution of IAS1.

This is why we believe that no progress can be made without moving away from the statement in IAS7 § 3 and why we disagree with the discussion paper's self-limitation in IN4 and 5.

Furthermore, the statement rests upon a premise that is no longer relevant as IFRS has introduced a lot more current values and hence are is longer a pure accruals accounting. Finally, the last statement is of limited value as distinguishing between return on and of investment has been discussed for years, some believe with no clear outcome and, others because it is an ill-founded distinction.

If one accepts the boundary of the study for the cash flow statement (non-financial entities), we believe the historical distinction between the portrayal of cash generated/used by operations, i.e how the activities portrayed in the statement of income translate into cash, and the portrayal of the general funding and remuneration of the entity's general capital providers must not only be retained but further developed.

We believe that IFRS lacks a discussion about this two activities (operation and financing) that is regularly obscured by the amalgamation of general capital and operations generated assets or liabilities (with "deferred" payment or collection).

Similarly, we do not believe that focusing on the net change in cash means that ending the cash flows statement with the cash variation is adequate. Such a presenattion does not allow a correct portrayal of the role of cash either as an investment or as a pure liquidity buffer of the general capital.

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 disagree with the concept of non-cash transaction being notional cash flows that must not be reported.

We believe that assuming a liability is similar to a debt issuance; similarly receiving a liquid asset is not unlike receiving cash[1].

We therefore strongly disagree with the reasoning in:

§1.25: in some leases (previously ias17 financial lease), the arrangement is in fact between a supplier, a financial institution and the buyer, the lack of cash transfer at the commencement of the lease is a pure modus operandi securing the rights of both the supplier and financial institution: one could consider the financial institution as compensating the payments; where the lessee and lessor are in direct relation, the deferred payments reflect the choice made by IFRS16 to recognize the RoU and related liability independently of the possibility for the lessee to fully pay upfront the RoU; in both cases what is key is the fact that a payment is necessary to access the RoU. For that reason the payments must be reflected in the operations cash flows of the entity. Providing information outside the statement would obscure the information about the means necessary to run the operations.

§1.26 and 1.28: receivables or reverse factoring are a way to manage working capital that introduces a financial institution in the loop. The first point is to understand the parties alternatives and what is acceptable to both parties in terms of deferred payment/collection : is the customer interested in paying over time and does he have access to alternate source of financing (cost, simplicity, availability)? is the supplier ready to provide payment facility

[1] the intangible recognized under IFRIC 12 in exchange of the revenue linked to the underlying constructed asset is not a liquid asset: one could consider it to be a true notional or non cash transaction. the expenses for the intangible are cash transactions.

and can he fund the facility through general or specific funding. Again, in both cases what is key is the fact that a payment is necessary to access the good/service and that the financing is linked to the existence of the operating transaction. For that reason, a flow must be reflected in the operations cash flows of the entity. Providing information outside the statement or only in the financing section would obscure the information about the means necessary to run the operations.

If we were assuming all receivables were factored and all payables reversed factored and classified in financing cash flows, operations cash flows would be nihil: operating cash flows would reflect
- the sole collection/payment flows through the factors,
- or the commercially agreed term of payments independently of the related effect of the factoring arrangements with those classified in operating or financing cash flows.

Section 2 The classification of cash flows

5. This section suggests that 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. Items that do not relate to operating activities should be reported in a separate section of the statement of cash flows.

6. The section also suggests that cash flows from operating activities should include capital expenditure, with a sub-total drawn before capital expenditure, and disclosure of the extent to which capital expenditure represents 'replacement' or 'expansion' should be encouraged.

7. The section also addresses the reporting of interest, and suggests that all cash flows in respect of financing liabilities should be reported in the financing category of the cash flow statement.

8. The discussion in this section also suggests that cash flows relating to tax should be reported in a separate section of the statement of cash flows.

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

Although we do not disagree with the items listed, we believe it would be better that each entity describes its concept of capital and how it manages it (cf current discussion at IASB).

This would help define the financing section which should have two major subclasses
- cash flows with capital providers other than equity: this section should include cash and other assets that the entity integrates in its liquidity management
- cash flows with equity instrument holders

Remuneration received or paid for those instruments should likewise be included in that section. It should not include remuneration, discounting effect or other cash effects of other assets/liabilities or provisions (i.e. not included in those two sub-classes).

We also believe a separate section should be used for changes in the consolidation perimeter (see hereunder question 4).

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'?

Our experience is that distinguishing and disclosing replacement and expansion capital expenditure is not achievable but in very limited circumstances.

Enhancing and distinguishing in a separate section the effects of changes in the consolidation perimeter would provide more meaningful benefits: bringing together entries and exits effects, considering how to best convey the financing structure of the acquisitions and sales (going beyond the currently reported cash paid for equity net of the acquiree's cash) and the consequences on the working capital (for example, would separating the cash collection of receivables and payments of payables at the time of purchase in that section be beneficial and not cumbersome?) or specific expenses (e.g. acquisition costs).

Whether or not to encompass in that section flows related to equity investees may warrant a discussion.

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

Please refer to question 3.

Question 6- Do you agree that tax is best dealt with in a separate section of the statement of cash flows?

We understand the idea of reporting separately the income tax on the ground of the inclusion of the pre-tax remuneration effect of items included in the financing section. Another reason could be that there are income taxes recorded both in net result, OCI and equity.

However, we believe that identifying separately the transactions with government (levies, vat-type collection, income taxes, grants scoped in IAS20, IFRIC 21 or IAS12 or others) in the statement of cash flows would be even more beneficial. Such an approach would provide an interesting link to integrated reporting and corporate social responsibility.

Whether in a separate section or in a subsection of the operations section is a secondary matter, which is more linked with the overall structure of the CFS and the other financial statements.

Section 3 Cash equivalents and the management of liquid resources

9. This section suggests that the statement of cash flows should be required to report inflows and outflows of cash, rather than cash and cash equivalents, and the statement of cash flows should contain a separate section that reports cash flows relating to the management of liquid resources.

10. It is also suggested that the net presentation of cash flows (other than those relating to operating activities) should be permitted only for instruments 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?

One dimension of the cash flow statement is to provide insights into the entity's liquidity management.

However contrarily to §3.17 we do not think this requires a new separate section of the statement of cash flows; if part of the entity's liquidity management, cash and other financial assets should be part of the finance section as they represent only a portion of an entity's activity to manage its liquidity (e.g. scheduling of debt repayments, lines of credits, etc.).

As stated in §3.19, the key attribute of the instruments eligible should be that they are readily convertible to cash (liquid market or eligible to central bank financing). Their value and counterparty risks are important elements, but for disclosure in coherence with the management policy and assessment of the management stewardship in that respect. As suggested in §3.20 and 21, they should not be part of the definition.

The question of the tax effect of their conversion to cash raised in §3.15 is an interesting question: either the tax effect should be netted off the instrument or a substantial tax consequence means that the instrument should not be regarded as part the liquidity management (even if it is cash).

We therefore disagree with the proposition to exclude cash equivalents and propose to extend the eligible instruments provided they fit into the entity's liquidity management and are readily convertible.

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

We do not disagree with the idea that various classes of instruments held for liquidity management should be separately reported. Reporting gross variations of those classes would however probably provide little value but in limited circumstances.

Section 4 Reconciliation of operating activities

11. This section suggests that a reconciliation of cash flows from operating activities and operating profit should be required in all cases, and not only where an indirect method cash flow statement is presented. Because the amounts reported in the reconciliation are not cash flows, it is suggested that the reconciliation should not be reported within the statement of cash flows, but as a supplementary note.

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 disagree with this prohibition as we believe that reconciliation with the statement of comprehensive income is a significant element to understand the cash conversion cycle of operations and to identify the re-measurements that are not cash generating until the de-recognition of the asset/liability.

We do not understand the choice illustrated in the discussion paper’s example, which basically starts from an unknown figure (cash generated from operations, before capital expenditure) which source and explanation are concealed in an appendix.

Section 5 Direct or indirect method?

12. It is suggested in this section that the direct method cash flow statement should neither be prohibited nor required, but that an accounting standard should identify particularly significant components of cash flows from operating activities and require disclosure either of the amounts 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?

We agree that the subject is not that of direct or indirect presentation, but to provide adequate information about the cash conversion cycle of operations and about the capital and liquidity management.

This is also why we believe a pure direct method to be inadequate as it does not provide the appropriate link with the other financial statements, nor a clear visibility on working capital. For that reason, we disagree with §5.13.

We observe that for the various components of cash flows from operating activities (inclusive or not of capital expenditure), the immediate reading of the movement in the various components of working capital is of significant value to understand the cash conversion cycle of the operations outputs and inputs, e.g.

capital expenditure (balancesheet increase) : +2100
variation in capex suppliers payables : - 300
net capex outflow (-a+b) : -1800

is providing a more direct access to relevant information than a mere
net capex outflow : -1800

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?

Because operations include transactions with customers, suppliers, employees and government, we believe this is a minima the main areas that should be separately described.

Separate categories would be necessary for suppliers: goods and services ‘expenses’ vs PPE or leases (likewise for governments: levies, vat-type collection, income taxes, grants etc.).

The nature of the activities may warrant additional distinctions to identify specific transactions (litigations, pension funds, a-periodic payments, dividends received from equity accounted for investments, dividends or interests on AFS etc.).

The presentation of assets sales, factoring and leases should also be considered (see previous sections).

To have a separate section or sub-section for capital expenditure is in our view of secondary importance and more linked to the possibility of having a subtotal before capital expenditures as the levels of investments have a different driver than the other operations cash flows (i.e. inter-period flexibility exists or aperiodicity is significant).

To allow the presentation of a management's operations cash flow measure might be considered in the same manner as it is currently examined for the income statement by the IASB.