



Mr. A Lennard
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Dear Mr. Lennard,

FRC Discussion Paper: Improving the Statement of Cash Flows

BusinessEurope welcomes the opportunity to respond to the UK Financial Reporting Council's Discussion Paper: Improving the Statement of Cash Flows (the DP). While Business Europe would normally not respond to proposals from individual national standard setters, we understand that this paper is expected to be of interest to the IASB in providing feedback for its Primary Financial Statements project and we therefore pleased to provide such input.

Our responses to the various questions posed in the paper are as follows:

Question 1

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

As noted in paragraph 1.6 of the DP, information on liquidity is reported in the balance sheet, but we agree that the statement of cash flows should provide enhancing information in respect of changes in liquidity and in financial structure.

As regards the DP's discussion on "performance", we consider that this is a term used to cover a wide range of situations. As a result, an entity may have multiple Key Performance Indicators, some of which may be based on cash generation or utilisation. Labelling the statement of income as the statement of financial performance, as proposed by the IASB, can consequently be confusing, and we would disagree with the summary in paragraph 1.20 of the DP since we do not believe that there is necessarily a single measure of performance and neither, we suspect, do analysts.



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 with the DP's proposals; however, we do not believe that changes to IFRS disclosures are necessary. Whilst IAS 7.43-44 may refer only to investing and financing activities, there are other disclosure requirements (such as IFRS 3.B64(f)/(i) and IAS 7.40 in respect of changes to the entity's structure) that meet users' needs.

Question 3

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

We would agree that in an ideal world this "should" happen, but there will need to be a definition that can be applied both practically and consistently across entities. We note that the DP's proposal is predicated on using the same notion of operating activities for both the statement of cash flows and the statement of income, where currently there is no requirement to disclose, nor definition of, operating income (as noted in para 4.5).

The DP proposes that the definition should expand on the notion of "principal revenue-producing activities". However, this would pre-suppose that an entity's share of the income of joint ventures and associates (and dividends received from these investments for cash flow statement purposes) would not be part of operating activities, a conclusion some entities would disagree with. If it considers this issue, the IASB should certainly take heed of investors' comments mentioned in paragraph 4.6 that the management's view on operating activities is useful information.

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'?

Whilst we do not have a fundamental objection to reporting capital expenditure within operating activities, what appears to be missing from the DP is a discussion of the remaining purpose of the investing activities' section. And there are other investing activities which can be seen as akin to capital expenditure and therefore should be presented in the same section of the cash flow statement:

- investments in new or existing joint ventures and associates (note also our response to Q3 above), and
- business combinations (as referred to in para 2.18).

We see little discussion in the DP about the treatment of proceeds on the sale of long-term items, other than in para 2.19 where it proposes that the same considerations would apply as for capital expenditure, and therefore they should be reported within operating activities. This would certainly avoid cash flows from investing activities being comprised mainly of cash receipts from divestments. However the logic behind including them within operating activities is not clear. It is therefore helpful (as shown in the recast example on page 36) to highlight this by labelling the sub-total as "Cash generated from operations, before capital expenditure".

As regards disclosure of the analysis of capital expenditure between "replacement" and "expansion", we would agree with the conclusion of the DP that this should remain "encouraged" (IAS 7.50(c)) rather than required. There can be significant practical difficulties in trying to provide such an analysis, as alluded to in paragraph 2.12.

In addition, we would take issue with the statement that it would seem logical (para 2.11) that replacement and expansion capital expenditure would be reported in different sections of the cash flow statement. Each is intended to increase cash inflows from operating activities, and each may do so in the current year. However whilst we do not accept the logic, we see that that is consistent with the DP's not proposing to move cash payments for investments in joint ventures and associates and business combinations out of investing activities.

Question 5

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

We agree with the proposal that all cash flows (including interest payments) relating to financing liabilities should be in the financing section.

The discussion of accretion expense in paragraph 2.32 is somewhat confusing because there is no cash outflow until the provision is settled. The accretion expense should be treated as a non-cash item to be adjusted for in arriving at cash flows from operating activities and be shown as a cash flow only when the resultant liability is settled.

Question 6

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

We agree with this proposal as regards tax paid. It can be somewhat meaningless, and then of little benefit to users, to try to allocate the amount between sections in the cash flow statement. The reasons expressed in paragraph 2.37 still stand. It would also provide some consistency with the presentation of tax in the statement of income for tax paid to be a deduction at the foot of the statement of cash flows.

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?

There seems to be an inconsistency in the discussion in this section of the DP, in that it does not appear to include cash within the scope of liquid resources, for example it states that "Liquid resources should be limited to assets that are readily convertible to cash". The subtotal "Net increase in liquid resources" in the example on page 36 clearly includes cash and is identical to "Net increase in cash and cash equivalents". We agree with IAS 7.9 (as quoted in para 3.6) that cash management includes the investment of excess cash in cash equivalents.

We support the proposal in paragraph 3.18 that cash flow information should be consistent with policies for liquidity management. Clear definitions are therefore required for cash equivalents and liquid resources.

In addition, the proposed changes to the cash flow statement would trigger a disconnect with the face of the balance sheet which would need to be addressed.

Question 8

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

We agree 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 (as defined in IFRS 7.6).

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 agree that this reconciliation is a key aspect of the cash flow statement. With reference to the starting point for such a reconciliation, we would agree that it could be profit or loss from operating activities, but we would refer to our response to Q3. We also note the SEC's challenge to US filers that is highlighted in paragraph 4.4.

Whilst we accept that the reconciliation does not report cash flows, there does not seem to be a benefit to users to have to refer to a supplementary note rather than see it within the statement itself. We also note that the example reconciliation on page 37 has a separate category for non-cash income and expenses, i.e. items passing in profit and loss. Whilst it may provide more clarity if items could be analysed into categories, for example decreases in trade receivables can be due to impairment charges (a non-cash



expense) and to the receipt of cash from customers (as mentioned in para 5.10), the same cost/benefit and impracticability arguments would apply as to the use of the direct method in preparing the cash flow statement (see Q10).

We do not agree, therefore, with the proposal to prohibit the inclusion of the reconciliation of cash flows from operating activities in the cash flow statement.

The example shows proceeds from sale of equipment in operating activities, based on the DP's proposals; we assume the proceeds were equal to its carrying amount as no gain or loss on sale is shown in the reconciliation of profit from operating activities to cash generated from operations before capital expenditure (although possibly it is included in "depreciation").

Question 10

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

We agree. There needs to be flexibility because there can be significant costs and practical difficulties in trying to apply the direct method, but an entity should be allowed to do so if it is cost-effective and practical in its particular circumstances and it considers the method results in more useful information.

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?

Disclosure of components should be a decision for each entity based on materiality. We do not believe that accounting standards should define requirements beyond those of existing IAS 7.20.

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

Yours sincerely,

Jérôme P. Chauvin
Deputy Director General

