

14 March 2017

**Strictly Private & Confidential**

For the attention of Andrew Lennard  
Financial Reporting Council  
8<sup>th</sup> Floor  
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Dear Sirs

**Discussion Paper: Improving the Statement of Cash Flows**

We are pleased to respond to your invitation to comment on your Discussion Paper: Improving the Statement of Cash Flows. We have responded to the questions posed in the Paper in turn below, however we also have some overall observations.

As noted in the Paper, IAS 7 has been in issue for many years and we would agree there is some room for improvement. As can be seen from our comments below, we agree with a number, although not all, of the FRC's suggestions.

However, whilst some of the FRC's suggestions are entirely new, many of the suggestions seem to propose a return to the structure and composition of a cash flow statement under old UK GAAP. Whilst we agree that a number of the proposed suggestions would be preferable to the requirements of IAS 7, and also acknowledge that the FRC has made certain comparisons with US GAAP in the discussion paper, the FRC may not gain much traction with the IASB by appearing – even though not explicitly – to hark back to a financial reporting standard (specifically FRS 1) on which current UK financial reporting is not based.

When developing the new UK financial reporting regime, and specifically FRS 102, the FRC had the opportunity to amend the IFRS for SMEs to more closely reflect the needs of the UK financial reporting and regulatory environment. Indeed the FRC did so in some respects, for instance by permitting the revaluation of property, plant and equipment and by developing the 'timing differences plus' method of accounting for deferred tax. The requirements for the statement of cash flows, however, were largely unchanged from the IFRS for SMEs and the IASB may well question why the FRC is challenging the requirements of IAS 7 at this stage but did not consider that those requirements (as summarised in the IFRS for SMEs) needed wholesale amendment when developing FRS 102.

We have responded to the questions in the Discussion Paper in turn below.

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

In our opinion, cash flow statement information is, and remains, useful to the users of financial statements, particularly when either an entity or the economic environment in which it operates is going through difficult times. As noted in the Paper, it provides information about how much cash has been generated from the business' normal trading activities and what it has spent it on, and how solvent in cash terms it is at the reporting date.

It is perfectly possible for a business to generate profits but fail because of a lack of cash. The presentation of relevant, useful information in the statement of cash flows enables users of the financial statements to evaluate the ability of an entity to continue in business and meet its liabilities as they fall due more effectively than would be possible from analysis solely of the income statement and statement of financial position.

**2. Do you agree that notional cash flows should not be reported in the statement of cash flows, but that non-cash transactions 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. Only actual cash flows should be reported.

We agree that transparent disclosure of *significant* non cash transactions would be appropriate.

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

Whilst we have sympathy for this viewpoint, we believe that this would be difficult within the current IFRS Framework because as noted in the Paper operating profit is not a defined term within IFRS. In the UK the concepts of operating profit and operating activities are well understood but this is not necessarily the case in all jurisdictions applying IFRS.

However, we agree the IASB should be encouraged to look at this as part of its wider review of the Framework and of what information should be presented in primary statements.

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

No, we do not agree with this proposal.

Our preferred approach would be for capital expenditure to be reported in a separate section of the statement of cash flows, distinct both from operating activities and from investment cash flows such as interest received and paid. We do not agree with the proposal that disclosure should be split between replacement and expansion as where to draw the line could be difficult and time consuming to determine in practice.

If cash flows from expansion were to be disclosed then for the sake of consistency cash flows from a contraction or downsizing of the business should be too (e.g. selling off a building because of the closure of an operation). Overall we do not see the benefit of disclosing capital payments and receipts from expansion and contraction when other sections of the statement of cash flows would not be split in this way.

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

We agree that all cash flows relating to financing liabilities should be reported in the financing category of the cash flow statement.

In our opinion the ability in IAS 7 to choose where to present interest/ dividend cash flows (as operating, investing or financing activities) has never made much sense. Interest cash flows arise from financing activities and should be shown as such, subject to the proposed exception for interest received from transactions with customers. Dividend cash flows are clearly investing cash flows and, again, should be shown as such.

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

Yes, we agree that tax should be dealt with in a separate section of the statement of cash flows. Whilst tax arises as a result of a business' normal operating activities (namely the generation of profit) it does not arise directly as a result of those activities but rather as a result of the taxation regime enacted in that jurisdiction. A separate presentation would therefore be preferable to subsuming taxation cash flows within those arising from operating activities. We note that this approach was taken in old UK GAAP.

**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 cash equivalents be defined, and why?**

Again, the idea that the statement of cash flows should include flows solely of cash and not cash equivalents references old UK GAAP. However we agree the suggestion has merit.

Cash equivalents, as defined in IFRS, includes short term deposits with a 'cut off point' of three months notice which we would agree, as stated in the Paper, is arbitrary. We would also note that the term 'Statement of Cash Flows' is not strictly accurate when applied to a statement prepared in accordance with IAS 7 (or for that matter FRS 102) – rather the statement produced is a 'Statement of movements in cash and cash equivalents'.

If cash equivalents were removed from the equation the term 'Statement of Cash Flows' would be factually accurate and include only those flows which can genuinely be accessed on demand and used to pay expenses, such as bank current accounts, demand deposits and overdrafts.

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

We agree with the proposal that net presentation should only be permitted for cash flows, other than those in respect of operating activities, which relate to financial instruments that are of the same class.

**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?**

Again, this proposal references old UK GAAP.

We have some reservations about this proposal. On the one hand, we agree that the presentation of the reconciliation as the first part of the cash flow statement means that non cash movements are shown on the face of the cash flow statement, which we can see is not ideal.

However, it is quite clear that these items are reconciling items and not cash movements; presentation on the face of the cash flow statement also has the benefit of prominence. Our preference would be to permit the reconciliation either to be shown as the first section of the cash flow statement or in the notes.

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

We agree that the direct method should neither be prohibited nor required. In practice most entities use the indirect method and it would be time consuming and in our view unduly onerous to require use of the direct method. However, it should still be able to be used if entities wish to do so.

**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?**

Standard setters should focus on those items which are likely to be of most interest to the users of the financial statements when assessing how a company has managed its cash resources – as stated in the Paper, how much cash it has generated from its normal business activities and what it has spent it on.

A balance needs to be struck between insufficient disaggregation and information overload. We agree with the Paper that some further disaggregation, compared to what IAS 7 currently requires, would result in improved information being presented in the statement of cash flows. However some possibilities referred to in the Paper – for instance splitting capital cash flows into replacement and expansion, or requiring detailed reconciliations of the working capital amounts, would in our opinion be unduly onerous for preparers and the costs of mandating its preparation would outweigh the benefits. As noted in the Paper, there is nothing to prevent the disclosure of information beyond the minimum requirements, should entities wish to do so.

We hope our comments are useful to you. If you have any questions on the contents of this letter, please contact Tessa Park.

Yours faithfully



Kingston Smith LLP