STAFF PAPER

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IASB Meeting

Project	**Disclosure Initiative**
Paper topic	Amendments to IAS 7—Reconciliation of liabilities related to financing activities —summary of feedback

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Objective

1. This paper provides a summary of feedback to the IASB from the outreach performed on the draft proposal to amend IAS 7 *Statement of Cash Flows* to include a reconciliation of liabilities related to financing activities.

Background

2. The draft proposed amendment to IAS 7 is part of the Disclosure Initiative project; its objective is to provide information that improves investors' understanding of changes in an entity's liabilities that relate to cash flows from financing activities. The IASB undertook this project following requests it had received from investors (including at the Discussion Forum[1]) to introduce a requirement that entities must disclose and explain their net debt reconciliation.

3. Initially the IASB considered whether to amend IAS 1 *Presentation of Financial Statements*. It decided, however, not to amend IAS 1 and asked the staff to suggest the possible scope of an alternative project that would consider disclosures about 'net debt'. This project would identifying why investors find the information useful and how they use the information.

[1] Discussion Forum: Financial Reporting Disclosure

4. In January 2014 we undertook a survey with investors to understand what information users require when reviewing cash flow information and how they use the information about debt. The results of the survey were presented to the IASB at its meeting in March 2014.

5. At its meeting in March 2014 the IASB tentatively decided to explore amending IAS 7 by requiring a reconciliation of the opening and closing liabilities that relate to cash flows from financing activities. The IASB asked the staff to undertake further outreach, with users and preparers, to understand whether the proposed amendment would meet the objective of providing information that improves users understanding of changes in an entity's liabilities that relate to cash flows from financing activities—thereby providing the information that investors have requested.

Outline of the draft proposal

6. The draft proposal would require liabilities for which the cash flows are or would be classified within financing activities, in accordance with paragraph 10 of IAS 7 to be reconciled to the opening and closing statement of financial position. By using the definition of financing activities in IAS 7, there is no need to define debt, which enables the project to move forward more quickly than if we tried to define debt.

7. The reconciliation is planned to work as follows:

   (a) Paragraph 10 of IAS 7 requires an entity to report cash flows during the period, classified by operating, investing and financing activities.

   (b) Paragraph 6 of IAS 7 defines financing activities as:

   > … activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

   (c) Paragraph 17 of IAS 7 notes:

   > The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of

capital to the entity. Examples of cash flows arising from financing activities are:

a) Cash proceeds from issuing shares of other equity instruments;

b) Cash payments to owners to acquire or redeem the entity's shares;

c) Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;

d) Cash repayments of amounts borrowed; and

e) Cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

8. The new paragraph would require cash flows arising from financing activities (as reported in the statement of cash flows), excluding contributed equity, to be reconciled to their corresponding liabilities in the opening and closing statement of financial position. By excluding cash flows from contributed equity, a reconciliation of the financing liabilities is disclosed.

Feedback on the draft proposals

9. As requested by the IASB, the project staff prepared illustrative examples of the draft proposed disclosure requirement, to discuss with investors. The objective of the discussions was to seek input from investors as to whether the draft proposal would improve their understanding of the changes in an entity's liabilities that relate to cash flows from financing activities.

10. Illustrative examples were discussed with investors and revised for feedback prior to being discussed at the joint meeting of the Global Preparers Forum (GPF) and Capital Markets Advisory Committee (CMAC) on 30 June 2014. The feedback that we received supported the proposed amendment. The following points were noted:

(a) A reconciliation of liabilities relating to financing activities provides users with the raw data required to perform their analysis of the entity.

(b) The amendment to IAS 7 should not prohibit disclosures from being provided on a net basis (liabilities relating to financing activities less cash and cash equivalents). This is because preparers might manage debt on a net basis and may already provide this information in the financial statements today. Changing to a gross reconciliation could be perceived as reducing information and limiting management's ability to explain financial and risk management strategies.

(c) It is important that investors are able to understand the components of financing activities, because investors like to understand the nature of financing liabilities; for example distinguishing between short- and long-term liabilities.

(d) It was noted that much of the information is currently available in the financial statements, but it is helpful if preparers can collate the information in a table because that makes it more accessible to investors.

(e) In addition to this improvement other areas that the IASB could consider in its long-term project (Principles of Disclosure) include:

(i) disclosure of interest paid and interest received;

(ii) disclosure of tax paid;

(iii) improved disclosures about covenants and encumbered assets related to liabilities; and

(iv) improved disclosures regarding the cash generated from operating activities. Users noted that they use financial statements to estimate free cash flows and hence need information on operating and financing activities.

11. On the basis of the outreach performed, the staff view is that there is overall support for the proposed amendment and it will achieve the objective of providing information that improves users understanding of changes in an entity's liabilities that relate to cash flows from financing activities.

12. Revised illustrative examples, updated in response to feedback received, are set out in the appendices of this paper. In the Exposure Draft we propose only to

amend the current illustrative example in IAS 7 as shown in Appendix B of this paper

Question to the IASB
Do the IASB members have any questions on the feedback to the outreach?

IFRS Taxonomy considerations

13. The staff have not identified any significant issues with introducing the effects of this proposed amendment to IAS 7 into the IFRS Taxonomy. The staff have not identified any inconsistencies between this amendment and other Standards.

14. To update the IFRS Taxonomy, the staff propose to follow current practice and exactly follow the text of the Standard and its supporting materials. Consequently, we propose to add elements for:

    (a) types of liabilities from financing activities; and

    (b) types of changes in these liabilities.

15. Specific elements would only be added to the extent that they are mentioned in the Illustrative Example, ie Borrowings and Lease liabilities for types of liabilities from financing activities, Cash flow changes, Acquisition changes and Lease liabilities changes from types of changes in liabilities from financing activities.

16. However, the reporting of the reconciliation of changes in liabilities from financing activities might require additional elements, which are not directly mentioned in the Illustrative Example. Such elements could include lines mentioned in Appendix A to this paper, namely:

    (a) for types of liabilities:

        (i) Short-term borrowings;

        (ii) Long-term borrowings;

        (iii) Pension liabilities; and

        (iv) Fair value of hedges.

    (b) for types of changes in these liabilities:

(i) Foreign exchange movement; and

(ii) Change in pension liabilities.

17. Although the elements above are not included in either the Standard or the Illustrative Example, the IASB could still choose to include them in the IFRS Taxonomy. These elements would be referenced as common practice in order to distinguish them from elements mentioned in the Illustrative Example.

18. The staff note that including these elements in the IFRS Taxonomy would not require an entity to classify the liabilities described by those elements as liabilities from financing activities. In addition, including these elements would not preclude entities from creating their own elements (extensions) for liabilities from financing activities not included in the IFRS Taxonomy.

Question

Does the IASB agree that the IFRS Taxonomy should include only elements directly mentioned in the amendment to IAS 7 and the Illustrative Example?

If not would you:

(a) add some or all of those described in paragraph 16 above or others from another source?

(b) not include some elements in the amendment to IAS 7 and Illustrative Example? If so, which ones and why?

Appendix A—Illustrative Examples supporting draft proposals
Illustrative Example 1

This example shows a possible presentation based on the draft proposal and includes non-cash movements and exchange adjustments as part of the reconciliation. These items are not currently required to be disclosed by IFRS.

In this Agenda Paper, currency amounts are denominated in 'currency units' (CU).

Extract from the Cash Flow Statement

	20X2	20X1
Financing Activities		
Proceeds from borrowings	-	3,000
Repayment of borrowings	(1,000)	-
Lease payments	(800)	(700)
	(1,800)	2,300
Proceeds from issue of shares and other equity	2,000	-
Transactions with non-controlling interests	-	50
Dividends paid to company shareholders	(300)	(300)
Dividends paid to non-controlling interests	(30)	(25)
Net cash used in financing activities	(130)	2,025

Notes to the Financial Statements

Liabilities related to financing activities

	20X2	20X1
Long-term borrowings	21,000	22,000
Short-term borrowings	1,200	1,000
Lease liabilities	3,500	4,000
Total liabilities related to financing activities	25,700	27,000

Reconciliation of changes in liabilities related to financing activities

	20X1	Cash flow	Non-cash changes		20X2
			New Leases	Exchange movement	
Long-term borrowings	22,000	(1,000)	-	-	21,000
Short-term borrowings	1,000	-	-	200	1,200
Lease liabilities (see note X[2])	4,000	(800)	300	-	3,500
	27,000	(1,800)	300	200	25,700

[2] The IASB proposed this in paragraph 103 of ED 2013/6: *Leases.*

Illustrative Example 2

This example includes pensions within the definition of liabilities relating to financing activities to illustrate that management may choose to include pensions within financing activities.

Extract from the Cash Flow Statement

	20X2	20X1
Financing Activities		
Proceeds from long-term borrowings	9,000	11,500
Repayments of long-term borrowings	(6,000)	(9,000)
Net decrease in short-term borrowings	(2,160)	(670)
Pension Payments	(300)	(300)
	540	1,530
Repurchase of shares	(5,200)	-
Net increase in non-controlling interests	35	125
Dividends paid	(4,770)	(4,900)
Dividends to non-controlling interests	(465)	(505)
Net cash used in financing activities	(9,860)	(3,750)

Notes to the Financial Statements

Liabilities related to financing activities

	20X2	20X1
Long-term borrowings	46,500	43,500
Short-term borrowings	1,000	3,160
Lease liabilities (see note X[3])	535	385
Pension liabilities (see note X[4])	2,500	2,600
Fair value of hedges related to long-term borrowings	(470)	(1,560)
Total liabilities related to financing activities	50,065	48,085

Reconciliation of changes in liabilities related to financing activities

	20X2	20X1
Opening balance	48,085	47,155
Exchange adjustments	(510)	(300)
Net cash flow	540	1,530
Acquisitions	1,900	-
Change in lease liabilities	150	100
Change in pension liabilities	(100)	(400)
	50,065	48,085

[3] The IASB proposed this in paragraph 103 of ED 2013/6: *Leases*

[4] A reconciliation of pension liabilities is required in accordance with IAS 19.

Appendix B

Proposed Updates to the Illustrative Example in IAS 7 —changes from IAS 7 are highlighted[5].

This is a mark-up of changes to the current illustrative example in IAS 7.

Consolidated statement of financial position as at end of 20X2

		20X2		20X1
Assets				
Cash and cash equivalents		230		160
Accounts receivable		1,900		1,200
Inventory		1,000		1,950
Portfolio investments		2,500		2,500
Property, plant and equipment at cost	3,730		1,910	
Accumulated depreciation	(1,450)		(1,060)	
Property, plant and equipment net		2,280		850
Total assets		7,910		6,660
Liabilities				
Trade payables		250		1,890
Interest payable		230		100
Income taxes payable		400		1,000
Long-term debt		2,300		1,040
Total liabilities		3,180		4,030
Shareholders' equity				
Share capital		1,500		1,250
Retained earnings		3,230		1,380
Total shareholders' equity		4,730		2,630
Total liabilities and shareholders' equity		7,910		6,660

[5] In this Staff Paper, currency amounts are denominated in 'currency units' (CU).

Indirect method statement of cash flows (paragraph 18(b))

Cash flows from operating activities		**20X2**
Profit before taxation	3,350	
Adjustments for:		
Depreciation	450	
Foreign exchange loss	40	
Investment income	(500)	
Interest expense	400	
	3,740	
Increase in trade and other receivables	(500)	
Decrease in inventories	1,050	
Decrease in trade payables	(1,740)	
Cash generated from operations	2,550	
Interest paid	(270)	
Income taxes paid	(900)	
Net cash from operating activities		1,380
Cash flows from investing activities		
Acquisition of subsidiary X net of cash acquired (Note A)	(550)	
Purchase of property, plant and equipment (Note B)	(350)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	200	
Net cash used in investing activities		(480)
Cash flows from financing activities **(reordered)**		
Proceeds from long-term borrowings	250	
Payment of finance lease liabilities	(90)	
Proceeds from issue of share capital	250	
Dividends paid[(a)]	(1,200)	
Net cash used in financing activities		(790)
Net increase in cash and cash equivalents		110
Cash and cash equivalents at beginning of period (Note C)		120
Cash and cash equivalents at end of period (Note C)		230

(a) This could also be shown as an operating cash flow.

Notes to the statement of cash flows (direct method and indirect method)

A. Obtaining control of subsidiary

During the period the Group obtained control of Subsidiary X. The fair values of assets acquired and liabilities assumed were as follows:

Cash	40
Inventories	100
Accounts receivable	100
Property, plant and equipment	650
Trade payables	(100)
Long-term debt	(200)
Total purchase price paid in cash	590
Less: Cash of Subsidiary X acquired	(40)
Cash paid to obtain control net of cash acquired	550

B. Property, plant and equipment

During the period, the Group acquired property, plant and equipment with an aggregate cost of CU1,250 of which CU900 was acquired by means of finance leases. Cash payments of CU350 were made to purchase property, plant and equipment.

C. Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks, and investments in money market instruments. Cash and cash equivalents included in the statement of cash flows comprise the following amounts in the statement of financial position:

	20X2	20X1
Cash on hand and balances with banks	40	25
Short-term investments	190	135
Cash and cash equivalents as previously reported	230	160
Effect of exchange rate changes	–	(40)
Cash and cash equivalents as restated	230	120

Cash and cash equivalents at the end of the period include deposits with banks of CU100 held by a subsidiary, which are not freely remissible to the holding company because of currency exchange restrictions.

The Group has undrawn borrowing facilities of CU2,000 of which CU700 may be used only for future expansion.

NEW NOTE INSERTED

D. Reconciliation of changes in liabilities related to financing activities

	20X1	Cash flow	Non-cash changes		20X2
			Acquisition	New leases	
Borrowings	1,040	250	200	-	1,490
Lease liabilities (see note X)[6]	-	(90)	-	900	810
	1,040	160	200	900	2,300

E. Segment information

	Segment A	Segment B	Total
Cash flows from:			
Operating activities	1,520	(140)	1,380
Investing activities	(640)	160	(480)
Financing activities	(570)	(220)	(790)
	310	(200)	110

[6] The IASB is proposing in ED 2013/6: Leases, paragraph 103.