STAFF PAPER

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IASB Meeting

Project	**Disclosure Initiative**		
Paper topic	Disclosures about restrictions on cash and about liquidity		
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Purpose of this paper

1. The purpose of this paper is to ask the Board to decide on how to move forward with the topics of:

   (a) disclosures about restrictions on cash; and

   (b) disclosures about liquidity.

Background

2. In December 2014 the Board published an Exposure Draft *Disclosure Initiative—Amendments to IAS 7* ('the IAS 7 Exposure Draft') which included proposals for the disclosure of:

   (a) a reconciliation of liabilities whose cash flows were, or whose future cash flows will be, classified as financing activities in the Statement of Cash Flows ('the reconciliation'); and

   (b) restrictions that affect the decisions of an entity to use cash and cash equivalents ('the cash restrictions proposals'). This proposed disclosure did not just deal with restrictions on the use of cash and cash equivalents (ie

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cash that is not available to be used by an entity).[1] It proposed disclosures about any circumstances that could create a disincentive for the entity to use cash and cash equivalent balances (for example, taxes or other costs payable on transfers of cash between group companies).

3. In October 2015, as a result of comments received on the IAS 7 Exposure Draft, the Board decided:

   (a) to finalise the reconciliation as a stand-alone amendment to IAS 7. This amendment was issued in January 2016; and

   (b) not to move ahead with the cash restrictions proposals until it had analysed feedback from the 2015 Agenda Consultation ('the Agenda Consultation') to help the Board assess whether the cash restrictions proposals should be included in a wider project on liquidity disclosures.

4. Agenda paper 11B from the April 2016 Board meeting summarises the feedback received from the Agenda Consultation and from the IAS 7 Exposure Draft. The feedback included requests from constituents (mainly investors) for more information about liquidity and restrictions on cash.

5. In April 2016, the US Financial Accounting Standards Board (FASB) exposed for comment a *Proposed Accounting Standards Update for the Statement of Cash Flows (Topic 230): Restricted Cash*. This Exposure Draft deals with the classification of restricted cash flows in the statement of cash flows and also proposes that entities disclose the nature of the restrictions on its cash and cash equivalents. The disclosure requirements proposed by the FASB are more limited in scope than those proposed in the IAS 7 Exposure Draft because they address only restrictions on the use of cash and cash equivalents and do not address disincentives for the use of cash and cash equivalent balances.

[1] Note paragraph 48 of IAS 7 already requires an entity to disclose significant cash and cash equivalent balances held that are not available for use by the group.

Staff analysis

6. After considering the feedback from the Agenda Consultation, and our research in this area, we have identified potential options for the Board relating to:

   (a) the cash restriction proposals; and

   (b) liquidity disclosures.

The cash restriction proposals

7. The cash restriction proposals were included in the IAS 7 Exposure Draft as a complement to the disclosure of a reconciliation of financing liabilities (see paragraph 2). Investors often offset cash balances against financing liabilities to arrive at a net debt figure. However, if there are significant disincentives to the use of cash balances this net debt figure could be misleading.

8. Hence, investors were in favour of the cash restrictions proposals because the proposals would have provided them with information about the nature and extent of such economic disincentives to the use of cash balances and that information could be used to calculate a more representative net debt figure.

9. Consequently the staff consider that the Board should continue to develop the cash restriction proposals. We think that the Board has two options:

   (a) finalise the cash restrictions proposals on their own; or

   (b) consider possible disclosures about cash restrictions as part of a broader research project on liquidity disclosures (see paragraphs 16-22).

10. Finalising the cash restriction proposals on their own would involve redeveloping the proposals of the IAS 7 Exposure Draft and testing such redeveloped proposals with investors.

11. The staff have undertaken research on this issue and considered feedback received on the IAS 7 Exposure Draft. In addition, we have analysed a second FASB Exposure

Draft issued in 2012, which proposed disclosures about available liquid funds that we believe are similar to the disclosures proposed in the IAS 7 Exposure Draft.[2]

12. On the basis of the research conducted so far, we think that combining the FASB proposals for the disclosure of available liquid funds with the proposals in the IAS 7 Exposure Draft could be the appropriate approach to moving forward with these disclosures. In particular, we think that the Board could require entities:

    (a) to provide a narrative description of the effect of regulatory, tax, legal, repatriation, and other conditions that could limit the transferability of cash and cash equivalents among the group entities; and

    (b) to provide, to the extent that it is possible, disclosures of the cash and cash equivalent balances that are subject to such limitations.

13. If the Board decides to move ahead with the cash restrictions proposals, you could also consider extending the disclosure requirements to other liquid assets (ie not just cash and cash equivalents). A possible way to do this is to require entities to disclose other types of assets (for example, marketable securities).

14. The advantage of finalising the cash restrictions proposals on their own is that the Board would be able to deliver timely improvements to the information about cash balances. The disadvantage of this option is its limited scope. It will not address the need that some investors have identified for more detailed disclosures about liquidity.

15. If the Board were to finalise the cash restriction proposals on their own, we think that this project could be developed as part of the Disclosure Initiative. Whether it will be necessary to re-expose the proposals will depend on the nature and extent of any changes made to the cash restriction proposals included the IAS 7 ED.

A research project on liquidity disclosures

16. Undertaking more detailed research on liquidity disclosures would be responsive to requests from investors who responded to the Agenda Consultation and the IAS 7 ED

[2] In 2012 the FASB issued a Proposed Accounting Standards Update on *Financial Instruments (Topic 825): Disclosures about Liquidity Risk and Interest Rate Risks* ('the FASB ED'). The FASB has no plans to finalise the proposals. The FASB ED included proposals about liquidity risk disclosures and interest rate risks disclosures.

urging the Board to look at the issue of liquidity disclosures in a more comprehensive way.

17. If the Board does choose to undertake more research on liquidity disclosures it has the option to develop the cash restriction proposals as part of that research (see paragraphs 7-15 for that discussion).

18. Agenda Paper 11B of the April 2016 Board meeting set out a number of suggestions from investors regarding how to improve disclosures about liquidity (see paragraphs 18-21 of that paper, which we have included in Appendix A). We believe that these suggestions could be considered as part of this broader project.

19. We note that a research project on liquidity disclosures is likely to take more time and require more resources that a limited project to develop disclosures about cash restrictions.

20. We note that any research work on liquidity disclosures is likely to overlap with other projects that the Board is working on. In particular, such research could overlap with:

    (a) any work on the statement of cash flows that is undertaken as part of Primary Financial Statements project; and

    (b) the research project on Financial Instruments with Characteristics of Equity.

21. We therefore, think that the Board should consider whether any research on liquidity disclosures should be undertaken as part of these projects.

22. We note that a decision to undertake more detailed work on liquidity disclosures would not preclude the Board from seeking to develop quick wins where appropriate as the research progresses.

Staff recommendations

23. We set out here all the potential options that we discussed from which we think the Board could choose:

    (a) Option 1—finalise the cash restriction proposals on their own in a narrow-scope project as part of the Disclosure Initiative and do not undertake more detailed research on liquidity disclosures;

(b) Option 2—finalise the cash restriction proposals on their own in a narrow-scope project as part of the Disclosure Initiative and then at a later date undertake more detailed research on liquidity disclosures;

(c) Option 3—do not finalise the cash restriction proposals on their own but include the proposals in a more detailed research project on liquidity disclosures; or

(d) Option 4—do nothing (ie do not finalise the cash restrictions proposals and do not undertake research on liquidity disclosures).

24. We recommend that, subject to there being sufficient resources, the Board should choose Option 2 because:

(a) there is clear demand from investors for more information about cash restrictions and liquidity;

(b) finalising the cash restrictions proposals on their own would provide some of the information requested by investors on a timely basis; and

(c) further research into liquidity would enable the Board to better understand the information that investors need.

Question for the Board
The staff recommend: (a) finalising the cash restrictions proposals on their own in a narrow-scope project as part of the Disclosure Initiative; and (b) undertaking more detailed research on liquidity disclosures. Do you agree?

Appendix A—Extract from Agenda Paper 11B of the April 2016 Board meeting: Suggestions from investors who responded to the Agenda Consultation for liquidity disclosures

18. One investor group stated that, to help assess an entity's liquidity, further information about the capital structure of the entity is needed. This group suggested a number of disclosures about financial debt, including:

    (a) an aggregate overview of nominal debt maturities per annum;

    (b) a reconciliation between the aggregate nominal amount and the aggregate carrying amount of debt in the statement of financial position;

    (c) information about where in the group structure the debt resides;

    (d) the entity's hedging policy for debt; and

    (e) information about assets pledged to providers of capital.

19. Another investor group stated that they need more information to help them understand management's plans for servicing existing debt and the risks associated with this. They also suggested requiring:

    (a) a more detailed maturity analysis of debt rather than the maturity analysis suggested in an example in IFRS 7;

    (b) information that enables investors to tie the numbers in maturity schedules to the numbers in the balance sheet by showing principal and interest payments separately, and reconciling total gross payments to the balance sheet (ie showing adjustments for discounting, fair value hedge adjustments, fair value option adjustments etc.); and

    (c) additional information about the entity's principal covenants, such as their terms and any restrictions in place.

20. One other investor group suggested that the disclosure of average and peak debt during the financial year would provide useful information.

21. Additionally, in response to the Online Survey conducted as part of the 2015 Agenda Consultation, a few investors suggested that more disclosures on financial debt and liquidity are needed, including:

(a) a definition of financial debt;

(b) information about covenants, actual performance on covenants and encumbered assets;

(c) a net debt reconciliation, as a next step for the already finalised amendment to IAS 7 (which requires disclosure of movements in liabilities from financing activities—in effect, 'gross debt'—although it does not prohibit disclosure of a net debt reconciliation).