STAFF PAPER

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Project	**Changes in liabilities arising from financing activities (IAS 7)**
Paper topic	Initial Consideration

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Introduction

1. The IFRS Interpretations Committee (Committee) has been informed by users of financial statements (hereafter, 'investors') that disclosure relating to changes in liabilities arising from financing activities applying IAS 7 *Statement of Cash Flows* does not always meet their information needs. In particular, investors raised concerns about observable trends in the quality and consistency of disclosure applying paragraphs 44A–44E of IAS 7.

2. In the light of that feedback, this paper considers whether application of the existing requirements of IAS 7 leads to disclosure that meets investor information needs. In other words, is the matter identified by investors one that requires standard-setting, or can it be addressed effectively by highlighting existing requirements?

3. The objective of this paper is to:

   (a) provide the Committee with a summary of the matter;

   (b) present our research and analysis; and

   (c) ask the Committee whether it agrees with our recommendation not to add the matter to its standard-setting agenda.

Structure of the paper

4. This paper includes:

   (a) background information;

   (b) outreach;

   (c) staff analysis; and

   (d) staff recommendation.

5. There are two appendices to this paper:

   (a) Appendix A—proposed wording of the tentative agenda decision.

   (b) Appendix B—submission.

Background information

The requirements in paragraphs 44A–44E of IAS 7

6. In January 2016, the Board amended IAS 7 to require entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendments added paragraphs 44A–44E to IAS 7 and were effective for annual reporting periods beginning on or after 1 January 2017.

7. Paragraph 44A of IAS 7 contains the disclosure objective:

   > An entity shall provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

8. The Board noted in paragraph BC16 that it developed the disclosure objective in paragraph 44A to reflect the needs of investors. Paragraphs 44B–44E set out requirements about how entities meet the disclosure objective in paragraph 44A. Paragraph 44B of IAS 7 states:

   > To the extent necessary to satisfy the requirement in paragraph 44A, an entity shall disclose the following changes in liabilities arising from financing activities:

(a) changes from financing cash flows;

(b) changes arising from obtaining or losing control of subsidiaries or other businesses;

(c) the effect of changes in foreign exchange rates;

(d) changes in fair values; and

(e) other changes.

9. As a part of the Board's activities to support consistent application, Nick Anderson, a member of the Board, published an article in February 2019, '[Changes in financing liabilities—what does good disclosure look like?]'. This article discusses the objective of the amendments and explains what entities can do to make their disclosures as useful as possible to investors.

Investor information needs

10. The Board developed the amendments to IAS 7 in response to investor information needs. Paragraph BC9 of IAS 7 explains that 'users highlighted that understanding an entity's cash flows is critical to their analysis and that there is a need for improved disclosures about an entity's debt, including changes in debt during the reporting period.' In addition, investors had repeatedly asked the Board to require entities to disclose a net debt reconciliation[1].

11. The Board undertook additional investor outreach during the development of the requirements to understand investors' reasons for requesting disclosure about net debt. Paragraph BC10 of IAS 7 states:

> …the Board identified that investors use a net debt reconciliation in their analysis of the entity:
>
> (a) to check their understanding of the entity's cash flows, because it provides a reconciliation between the

[1] Investors often refer to a 'net debt reconciliation'. This is a reconciliation of movements in a net balance comprising debt less cash and cash equivalents. Some entities, including many in the UK, choose to provide a net debt reconciliation.

statement of financial position and the statement of cash flows;

(b) to improve their confidence in forecasting the entity's future cash flows when they can use a reconciliation to check their understanding of the entity's cash flows;

(c) to provide information about the entity's sources of finance and how those sources have been used over time; and

(d) to help them understand the entity's exposure to risks associated with financing.

12. When developing the requirements, the Board noted that one challenge in responding to this need was that debt is not defined or required to be disclosed in IFRS Standards, and finding a commonly agreed definition of debt would be difficult. However, the Board decided that it could instead use the definition of financing activities in IAS 7. 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.'

13. Consequently, the amendments require entities to disclose changes in liabilities arising from financing activities. Paragraph 44C of IAS 7 defines these liabilities as 'liabilities for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities.'

The submission

14. There are now two years of observable practice applying paragraphs 44A–44E of IAS 7. Based on that observable practice, most entities elect to fulfil the disclosure objective in paragraph 44A by providing a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities ('IAS 7 reconciliation'). This reflects paragraph 44D, which states:

> One way to fulfil the disclosure requirement in paragraph 44A is by providing a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities, including the changes identified

> in paragraph 44B. Where an entity discloses such a reconciliation, it shall provide sufficient information to enable users of the financial statements to link items included in the reconciliation to the statement of financial position and the statement of cash flows.

15. Although not mandatory, an IAS 7 reconciliation is an effective way of fulfilling the disclosure requirements. This is because it:

    (a) provides relevant information to investors about changes in liabilities arising from financing activities, considering the needs of investors summarised in paragraph BC10; and

    (b) provides a link between the statement of financial position, the statement of cash flows and other related notes in the financial statements. Together, the IAS 7 reconciliation and the statement of cash flows provide investors with similar information to a net debt reconciliation.

16. Based on their analysis of financial statements, investors have raised concerns about observable trends in the quality and consistency of IAS 7 reconciliations. Their particular concerns relate to:

    (a) inconsistent or unclear definitions of 'debt' or 'net debt' used as the basis for the IAS 7 reconciliation. This often means investors are unable to identify liabilities arising from financing activities or link movements in the IAS 7 reconciliation to other areas of the financial statements;

    (b) insufficient disaggregation and inadequate explanation; and

    (c) presentation and disclosure errors.

17. Because of these shortcomings, investors are often unable to evaluate changes in liabilities arising from financing activities as part of their cash flow analysis. In other words, the disclosures provided often do not meet the disclosure objective in paragraph 44A of IAS 7.

18. Appendix B to this paper summarises the feedback from investors and provides further details regarding each of their concerns.

19. We reviewed publicly available financial statements to confirm investors' findings and conclusions summarised in Appendix B. We selected a sample of 50 entities with material cash flows arising from financing activities and material financial liabilities. We reviewed their 2017 financial statement disclosure and, if available, their 2018 disclosure. In summary, our limited research confirmed the feedback provided by investors. Of the 92 sets of financial statements that we reviewed[2], 82 include an IAS 7 reconciliation. We found many examples of each concern raised by investors.

20. In our research, we specifically considered the objective of the amendments—to enable investors to evaluate changes in liabilities arising from financing activities. For each set of financial statements, we assessed whether it was possible to link the items included in the IAS 7 reconciliation to the statement of financial position and the statement of cash flows in a way that enabled a complete understanding of how an entity's 'net debt' position had moved during the year. This was possible in only 41 of the 82 sets of financial statements reviewed.

Outreach

21. We decided not to perform outreach on this matter for a number of reasons:

    (a) the Board conducted extensive outreach as part of the development of the amendments to IAS 7. Therefore, we already had sufficient information about:

        (i) investors' focus on the cash flow, liquidity and debt of entities;

        (ii) the resulting information needs of investors regarding changes in financing liabilities; and

        (iii) how the Board considered investor information needs in developing the amendments.

    (b) investors perform extensive analysis of financial statements, and thus are well placed to comment on widespread trends in disclosure. In addition, our

[2] This represents 2017 and 2018 financial statements for 42 entities, and 2017 financial statements for eight entities that have yet to release their 2018 financial statements.

research (see paragraphs 19–20 above) confirmed investors’ findings and conclusions.

Staff analysis

22. In the light of investors’ concerns, we considered whether the requirements in IAS 7 and other Standards address the shortcomings identified. In other words, do the Standards give entities the tools they need to prepare disclosures that effectively meet the objective in paragraph 44A of IAS 7?

23. Specifically, we analysed whether the Standards require an entity that provides an IAS 7 reconciliation to:

    (a) use consistent definitions that enable an investor to link items in the IAS 7 reconciliation to other areas of the financial statements;

    (b) disaggregate information sufficiently, and provide adequate explanation of items, in the reconciliation; and

    (c) avoid presentation and disclosure errors.

24. Our analysis assumes an entity has elected to prepare an IAS 7 reconciliation. We have taken this approach for two reasons:

    (a) the matter identified by investors—and supported by our research (see summary in paragraphs 19–20 above)—relates to the quality of information provided in IAS 7 reconciliations; and

    (b) our research identified that most entities have elected to prepare an IAS 7 reconciliation.

Consistent definitions and reconciliation to other areas of the financial statements

Investor feedback

25. Investors say understanding cash flows is critical to their analysis. Recognising the importance of cash flow information, many entities elect to provide additional disclosure to that required by IAS 7. In many instances, entities choose to define a

'net debt' or 'debt' measure in their financial statements and use this as the basis for their IAS 7 reconciliation.

26. Such disclosure can be helpful to investors. This is because it can provide additional information about what the entity considers to be sources of finance and how it has used and managed such sources over time. However, investor feedback suggests that additional disclosure is helpful only if it does not prevent investors from linking items in the reconciliation to other areas of the financial statements. For example, investors say some entities define 'net debt' in a way that is inconsistent with—and cannot be linked to—financial liabilities in the statement of financial position or disclosed in the notes. This limits investors' ability to check their understanding of an entity's cash flows.

Applying the requirements

27. If an entity elects to disclose an IAS 7 reconciliation, it is required to disclose:

(a) changes in liabilities arising from financing activities as defined in IAS 7 (paragraphs 44A-44C);

(b) any additional information separately in the IAS 7 reconciliation (paragraph 44E); and

(c) sufficient information to enable investors to link items included in the IAS 7 reconciliation to the statement of financial position and the statement of cash flows (paragraph 44D).

Disclosure of changes in liabilities arising from financing activities

28. The requirements in paragraphs 44A–44B refer to changes in liabilities arising from financing activities, defined in paragraph 44C as:

> …liabilities for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities. In addition, the disclosure requirement in paragraph 44A also applies to changes in financial assets (for example, assets that hedge liabilities arising from financing activities) if cash flows from those financial assets were, or future cash flows will be, included in cash flows from financing activities.

29. Using this definition helps to ensure that an investor can link items in the IAS 7 reconciliation to other areas of the financial statements—this is because the IAS 7 reconciliation:

    (a) reconciles the opening and closing balances *in the statement of financial position* for liabilities arising from financing activities, and

    (b) presents the changes in such liabilities, including changes arising from cash flows (reported *in the statement of cash flows*) as well as non-cash changes.

30. If an entity chooses to define, and reconcile, a different 'net debt' measure, this does not remove the requirement to identify the entity's liabilities arising from financing activities as defined in paragraph 44C.

Separate disclosure of additional information

31. Entities are not prevented from providing the information required by paragraph 44A in a format that combines it with information about changes in other assets and liabilities. Paragraph 44E of IAS 7 states:

    > If an entity provides the disclosure required by paragraph 44A in combination with disclosures of changes in other assets and liabilities, it shall disclose the changes in liabilities arising from financing activities separately from changes in those other assets and liabilities.

32. Paragraph BC21 explains that:

    > The Board did not intend to prevent entities from providing information required by paragraph 44A in a format that combines it with information about changes in other assets and liabilities. For example, an entity could provide that information as part of a net debt reconciliation, as described in paragraph BC20(b). To ensure users can identify the information required by paragraph 44A, the format selected needs to distinguish that information from information about changes in other assets and liabilities…

33. Accordingly, we think it is clear that an entity is permitted to provide additional information in its IAS 7 reconciliation, as long as it discloses that additional information separately. For example, an entity might include additional sources of

finance (such as pension liabilities) that it considers to be ‘debt’, but which are not captured by the definition in paragraph 44C. Application of the requirements in paragraph 44E helps an entity to provide such additional information in a way that does not prevent an investor from linking items in the IAS 7 reconciliation to other areas of the financial statements.

Reconciliation to other areas of the financial statements

34. If an entity elects to provide an IAS 7 reconciliation, paragraph 44D requires the entity to:

> …provide sufficient information to enable users of the financial statements to link items included in the reconciliation to the statement of financial position and the statement of cash flows.

35. This paragraph directly addresses the concern identified by investors. This is because it *requires* an entity to ensure that an investor can link items in its IAS 7 reconciliation to the statement of financial position and the statement of cash flows. For example, we think application of paragraph 44D would lead an entity to include in its IAS 7 reconciliation:

    (a) each liability arising from financing activities that the entity reports in the statement of financial position (or in the notes); and

    (b) each movement that the entity reports in the statement of cash flows relating to those liabilities.

Conclusion

36. Applying the requirements in paragraphs 44A–44E of IAS 7, entities that elect to provide an IAS 7 reconciliation are required to:

    (a) reconcile liabilities arising from financing activities as defined in IAS 7;

    (b) disclose any additional information separately from the information required in (a); and

    (c) provide information in a way that enables investors to link items included in the reconciliation to the statement of financial position and the statement of cash flows (or related notes).

37. Accordingly, we conclude that:

(a) the requirements in IAS 7 address investor concerns about consistent definitions and linking the IAS 7 reconciliation to other areas of the financial statements; and

(b) standard-setting is not required to address this matter.

Sufficient disaggregation

Investor feedback

38. Investors say the information in IAS 7 reconciliations is not always sufficiently disaggregated to meet their information needs. Disaggregating information at the appropriate level is important because it:

(a) enables investors to link items in the reconciliation to other areas of the financial statements (as required by paragraph 44D); and

(b) contributes significantly to investors' understanding of an entity's cash flows and sources of finance (as described in paragraph BC10).

Applying the requirements

39. IAS 7 and IAS 1 *Presentation of Financial Statements* contain requirements to help entities determine the appropriate level of disaggregation. In meeting the objective set out in paragraph 44A of IAS 7, entities apply:

(a) the requirements on (dis)aggregation that apply generally to IFRS financial statements, including the notes (paragraphs 30 and 30A of IAS 1); and

(b) the disaggregation requirements for changes in liabilities arising from financing activities set out in paragraph 44B of IAS 7.

40. Paragraph 30A of IAS 1 states:

> When applying this and other IFRSs an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates information in the financial statements, which include the notes. An entity shall not reduce the understandability of its financial statements by obscuring

material information with immaterial information or by aggregating material items that have different natures or functions.

41. Accordingly, we would expect an entity to disclose any individually material items separately in its IAS 7 reconciliation. This includes material classes of liability (or asset) arising from financing activities and material reconciling items (ie cash or non-cash changes, including the changes identified in paragraph 44B).

42. Paragraph 44B requires disclosure of the following changes in liabilities arising from financing activities, to the extent necessary to satisfy the objective in paragraph 44A:

(a) changes from financing cash flows;

(b) changes arising from obtaining or losing control of subsidiaries or other businesses;

(c) the effect of changes in foreign exchange rates;

(d) changes in fair values; and

(e) other changes.

43. We note that the final item listed in paragraph 44B is ‘other changes’ (paragraph 44B(e)). Application of paragraph 44B therefore requires an entity to consider disclosing more than the four specific line items described in paragraph 44B(a)-(d).

44. Paragraph BC10 is also helpful to entities in applying judgement to determine the appropriate level of disaggregation. This is because it explains the investor needs that underlie the objective in paragraph 44A. For example,

(a) paragraph BC10(c) notes that investors need information about an entity’s sources of finance. Consideration of this investor need might lead an entity to disaggregate and disclose individual sources of finance (ie liabilities) separately in its IAS 7 reconciliation if those individual sources were material.

(b) paragraph BC10(a) explains that investors want to check their understanding of an entity’s cash flows. Investors can only check their understanding if the cash and non-cash changes are disaggregated into clearly labelled change (ie movement) categories including those identified in paragraph 44B.

Good practice

45. The research we performed (described in paragraphs 19–20 of this paper) both reiterated the concern about insufficient disaggregation but also revealed some examples of good practice. These included:

(a) not aggregating items that appear individually elsewhere in the financial statements, for example disclosure required applying IFRS 7 *Financial Instruments: Disclosures*;

(b) avoiding the use of substantial ‘other’ or ‘miscellaneous’ items in the IAS 7 reconciliation;

(c) disaggregating items such as foreign exchange movements and fair value movements; and

(d) disaggregating inflows and outflows to avoid presenting net movements.

Conclusion

46. We think the requirements in IAS 7 and IAS 1 provide an adequate basis for an entity to apply judgement and determine the appropriate level of disaggregation in an IAS 7 reconciliation. The explanation in paragraph BC10 of the investor needs underlying the objective in paragraph 44A of IAS 7 is helpful in this regard.

47. Consequently, we conclude that:

(a) the requirements in IAS 7 and IAS 1 address investor concerns about inadequate disaggregation; and

(b) standard-setting is not required to address this matter.

Adequate explanation

Investor feedback

48. Investors say some entities do not adequately explain items in the IAS 7 reconciliation. This includes cases in which such explanation is critical to investor

understanding (see Appendix B to this paper). Investors provided the following examples:

(a) the accounting treatment of items summarised and disclosed in the IAS 7 reconciliation is not always clear (for example, there is often no explanation about the treatment of hedging instruments, interest paid or accrued and cash collateral)—see paragraph 51(a) below.

(b) the nature of items is not always clear from their descriptions (this might apply, for example, to items described as 'other financial liabilities' or changes described as 'other' or 'miscellaneous')—see paragraph 51(b) below.

Applying the requirements

49. An entity determines the appropriate structure for its IAS 7 reconciliation, having determined the appropriate level of disaggregation as described above. Thereafter, the entity considers what, if any, additional explanation is needed about the items in the reconciliation to meet the disclosure objective in paragraph 44A. Paragraph BC18 of IAS 7 is helpful in this respect. It explains how an entity applies judgement in considering whether it has met the objective in paragraph 44A:

> …The Board noted that when an entity is considering whether it has fulfilled the disclosure requirement, it should take into consideration:
>
> (a) the extent to which information about changes in liabilities arising from financing activities provides relevant information to its users, considering the needs of users summarised in paragraph BC10; and
>
> (b) whether the entity is satisfying the disclosure requirement through other disclosures included in the financial statements.

50. We think that considering the investor needs summarised in paragraph BC10 will help entities determine whether they have adequately explained items included in the IAS 7 reconciliation. For example:

(a) paragraph BC10(a) explains that investors want to check their understanding of an entity's cash flows, and reconcile between the statement of financial position and the statement of cash flows. With this in mind, entities would be expected to explain how they have treated items such as hedging instruments or cash collateral in the IAS 7 reconciliation. This is because such items, if not explained, may prevent an investor from understanding all the cash and non-cash changes in the period and reconciling to the statement of financial position and statement of cash flows.

(b) paragraph BC10(c) explains that investors want information about an entity's sources of finance. With this in mind, entities would be expected to describe each class of liability (and asset) included in the reconciliation in a way that makes the source of finance clear; we think a description such as 'other financial liability' does not provide an investor with the information it needs about that source of finance and would require additional explanation.

51. In addition, paragraph 112(c) of IAS 1 requires an entity to disclose 'information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them.' Accordingly, an entity is required to explain items in the IAS 7 reconciliation to the extent that such explanation is

(a) relevant to an investor's understanding, considering the objective in paragraph 44A of IAS 7 and the investor needs in paragraph BC10; and

(b) information is not presented elsewhere in the financial statements.

52. For example, entities might explain:

(a) any individually significant or unusual financing transaction;

(b) how it has treated items such as hedging instruments (including both assets and liabilities), interest paid or accrued and cash collateral in the reconciliation; and

(c) the composition of any 'other' or 'miscellaneous' item included in the reconciliation (including both classes of liabilities arising from financing activities as well as changes in such liabilities).

53. If relevant information is presented elsewhere, we think it is helpful to include references to the notes in which the relevant information is disclosed. This is because the IAS 7 reconciliation represents a summary for investors to evaluate all changes in liabilities arising from financing activities.

Conclusion

54. We think the requirements in IAS 7 and IAS 1 provide an adequate basis for an entity to apply judgement and determine the explanations necessary to meet the objective in paragraph 44A of IAS 7. Consequently, we conclude that:

(a) the requirements in IAS 7 and IAS 1 address investor concerns about inadequate explanation; and

(b) standard-setting is not required to address this matter.

Presentation and disclosure errors

Investor feedback

55. The final concern raised by investors is that they found numerous presentation and disclosure errors in IAS 7 reconciliations, such as:

(a) changes from cash flows in the reconciliation that were different from identical items in the statement of cash flows;

(b) opening balances in the reconciliation that were different from identical items in the financial instrument disclosure note and/or in the statement of financial position; and

(c) double-counting of items or inconsistent application – for example, (i) the same cash movement appearing within two line items in the reconciliation, or (ii) interest accrued that is included in the carrying amount of liabilities arising from financing activities but the associated interest expense (or interest cashflow) is not included in the changes in such liabilities .

56. Our research (described in paragraph 19–20) identified similar errors. Such errors, when material, mean that the objective in paragraph 44A of IAS 7 is not met. This is

because the errors limit an investor's ability to evaluate changes in liabilities arising from financing activities.

Staff Conclusion

57. When an entity chooses to fulfil the objective in paragraph 44A of IAS 7 by providing an IAS 7 reconciliation, the entity applies the requirements in paragraphs 44A–44E of IAS 7, and paragraphs 30A and 112(c) of IAS 1, in preparing that reconciliation. In particular, the entity:

    (a) prepares its IAS 7 reconciliation in a way that enables investors to evaluate changes in liabilities arising from financing activities and link items included in the reconciliation to other areas of the financial statements. In doing this, an entity applies:

        (i) paragraph 44C of IAS 7 to identify liabilities arising from financing activities and use them as the basis for the reconciliation;

        (ii) paragraph 44E of IAS 7 to disclose changes in liabilities arising from financing activities separately from changes in any other assets and liabilities;

        (iii) paragraph 44D of IAS 7 to provide sufficient information to enable investors to link items included in the reconciliation to the statement of financial position and the statement of cash flows.

    (b) applies judgement to determine whether it has provided the appropriate level of disaggregation, and adequate explanation, of items included in the reconciliation. In making this judgement, an entity applies paragraph 44B of IAS 7 and paragraphs 30A and 112(a) of IAS 1. An entity also considers the investor information needs described in paragraph BC10 of IAS 7.

58. In the light of investors' concerns, entities need to consider the requirements carefully in order to ensure that their disclosure meets the objective set out in paragraph 44A of IAS 7. Application of the requirements identified above should result in disclosure that meets that objective and addresses the concerns identified by investors.

59. Accordingly, we conclude that application of the requirements of IAS 7, together with requirements in IAS 1, leads to disclosure that enables investors to evaluate changes in liabilities arising from financing activities.

Question 1 for the Committee
Does the Committee agree with our analysis that application of the requirements in IAS 7 and IAS 1 lead to disclosure that enables investors to evaluate changes in liabilities arising from financing activities, summarised in paragraphs 57–59 of this paper?

Should the Committee add this matter to its standard setting agenda?

Is it necessary to add to or change IFRS Standards to improve financial reporting?[3]

60. Based on our analysis, we think the requirements in IAS 7 and IAS 1 provide an adequate basis for an entity to disclose an IAS 7 reconciliation that enables investors to evaluate changes in liabilities arising from financing activities.

Staff recommendation

61. On the basis of our assessment of the Committee's agenda criteria in paragraphs 5.16– 5.17 of the *Due Process Handbook* (discussed in paragraph 60 of this paper), we recommend that the Committee does not add this matter to its standard-setting agenda. Instead, we recommend that the Committee publish a tentative agenda decision that explains how an entity applies the requirements in IAS 7 and IAS 1 when providing information about changes in liabilities arising from financing activities.

62. Appendix A to this paper outlines the proposed wording of the tentative agenda decision.

[3] Paragraph 5.16(b) of the *Due Process Handbook.*

Questions 2 and 3 for the Committee

2. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda?
3. Does the Committee have any comments on the proposed wording of the tentative agenda decision outlined in Appendix A to this paper?

Appendix A—Proposed wording of the tentative agenda decision

Disclosure of changes in liabilities arising from financing activities (IAS 7 *Statement of Cash Flows*)

The IFRS Interpretations Committee (Committee) has been informed by users of financial statements (investors) that disclosure relating to changes in liabilities from financing activities applying IAS 7 *Statement of Cash Flows* does not always meet their information needs. In particular, investors highlighted shortcomings in the disclosure of a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities (IAS 7 reconciliation).

Investors said that IAS 7 reconciliations provided often do not enable them to evaluate changes in liabilities arising from financing activities. This is because the disclosures provided often:

(a) cannot be linked to other areas of the financial statements, such as the statement of financial position and the statement of cash flows;

(b) do not adequately disaggregate or explain (i) liabilities arising from financing activities or (ii) cash and non-cash changes in those liabilities; and

(c) contain errors.

In the light of that feedback, the Committee considered whether application of the existing requirements of IAS 7 leads to disclosure that meets investor information needs.

Meeting the disclosure objective (Paragraph 44A of IAS 7)

Paragraph 44A of IAS 7 requires an entity to provide 'disclosures that enable investors to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.' To the extent necessary to satisfy this objective, paragraph 44B specifies that an entity discloses the following changes in liabilities arising from financing activities:

(a) changes from financing cash flows;

(b) changes arising from obtaining or losing control of subsidiaries or other businesses;

(c) the effect of changes in foreign exchange rates;

(d) changes in fair values; and

(e) other changes.

The Board explained in paragraph BC16 that it developed the disclosure objective in paragraph 44A to reflect the needs of investors, including those summarised in paragraph BC10. The Board also noted in paragraph BC18 that when considering whether it has fulfilled the objective in paragraph 44A, an entity takes into consideration the extent to which information of changes in liabilities arising from financing activities provides relevant information to investors, considering the needs of investor summarised in paragraph BC10. These needs are:

(a) to check their understanding of the entity's cash flows and use that understanding to improve their confidence in forecasting the entity's future cash flows;

(b) to provide information about the entity's sources of finance and how those sources have been used over time; and

(c) to help them understand the entity's exposure to risks associated with financing.

Consequently, the Committee concluded that, to meet the disclosure objective in paragraph 44A of IAS 7, an entity must provide disclosures that enable investors to check their understanding of the entity's cash flows, to provide information about the entity's sources of finance and to help them understand the entity's exposure to risks associated with financing as described in paragraph BC10.

Reconciling between the opening and closing balances of liabilities arising from financial activities

Paragraph 44D states that 'one way to fulfil the disclosure requirement in paragraph 44A is by providing a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities, including the changes identified in paragraph 44B. When an entity discloses such a reconciliation, it shall provide sufficient information to enable investors to link items included in the reconciliation to the statement of financial position and the statement of cash flows.'

Consequently, when an entity discloses a reconciliation as described in paragraph 44D, the Committee observed that the entity provides information that enables investors to link items included in the reconciliation to other areas of the financial statements. In doing this, an entity applies:

(a) paragraph 44C to identify liabilities arising from financing activities and use them as the basis of the reconciliation. Paragraph 44C defines these liabilities as 'liabilities for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities.' If an entity also chooses to define, and reconcile, a different 'net debt' measure, this does not remove the requirement to identify the entity's liabilities arising from financing activities as defined in paragraph 44C.

(b) paragraph 44E to disclose changes in liabilities arising from financing activities separately from changes in any other assets and liabilities. Paragraph 44E states 'if an entity provides the disclosure required by paragraph 44A in combination with disclosures of changes in other assets and liabilities, it shall disclose the changes in liabilities arising from financing activities separately from changes in those other assets and liabilities.'

(c) paragraph 44D of IAS 7 to provide sufficient information to enable investors to link the items included in the reconciliation to amounts reported in the statement of financial position and the statement of cash flows, or related notes. The information provided must enable investors to link (i) the opening and closing balances of the liabilities arising from financing activities reported in the reconciliation, to (ii) amounts reported in the entity's statement of financial position (or related notes) regarding those liabilities. An entity avoids errors in doing so.

The Committee also observed that an entity applies judgement in determining the extent to which it disaggregates and explains the changes in liabilities arising from financing activities included in the reconciliation, considering the investor information needs described in paragraph BC10. In this respect, the Committee noted the following:

(a) in disaggregating liabilities arising from financing activities, and cash and non-cash changes in those liabilities, an entity applies paragraph 44B of IAS 7 and paragraph 30A of IAS 1 *Presentation of Financial Statements*. Paragraph 30A of IAS 1 states that 'an entity shall not reduce the understandability of its financial statements…by aggregating material items that have different natures or functions.' Accordingly, in considering the investor information needs in paragraph BC10, an entity discloses any individually material items separately in the reconciliation. This includes material classes of liability (or asset) arising from financing activities and material reconciling items (ie cash or non-cash changes).

(b) in explaining liabilities arising from financing activities, and cash and non-cash changes in those liabilities, an entity applies paragraph 44B of IAS 7 and paragraph 112(c) of IAS 1 *Presentation of Financial Statements*. Paragraph 112(c) of IAS 1 requires an entity to disclose ‘information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them.’ Accordingly, in considering the investor information needs in paragraph BC10, an entity explains each class of liability (or asset) arising from financing activities included in the reconciliation and each reconciling item in a way that (i) provides information about its sources of finance, (ii) enables investors to check their understanding of the entity’s cash flows, and (iii) enables investors to link items to the statement of financial position and the statement of cash flows, or related notes.

The Committee concluded that the requirements in IFRS Standards provide an adequate basis for an entity to disclose information about changes in liabilities arising from financing activities that enables investors to evaluate those changes. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda

Appendix B—Submission

B1. We prepared a summary below of the matter identified based on feedback received from investors. We shared the summary with some investors to confirm that it appropriately reflects their concerns.

Overview

Investors have expressed concerns about the quality and consistency of application of the disclosures required by paragraphs 44A–44E of IAS 7 *Statement of Cash Flows*. Those requirements were effective for annual reporting periods beginning on or after 1 January 2017. Consequently, investor feedback is based on two years of observable disclosure in practice.

Paragraph 44A of IAS 7 requires an entity to 'provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.' Paragraph 44C defines liabilities arising from financing activities as 'liabilities for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities.

Investor information needs

The Board developed the requirements in paragraphs 44A–44E of IAS 7 in response to investor information needs. As noted in the basis for conclusions, investors highlighted that understanding an entity's cash flows is critical to their analysis and that there is a need for improved disclosures about an entity's debt, including changes in debt during the reporting period (see paragraph BC9 of IAS 7). This is because the cash flow statement alone does not always give investors all the information they need for their analyses.

Example

Take two entities, identical in all respects apart from their financing structure. Company A is acquired for CU100 million. It has no cash or debt. The cost of the acquisition, which is shown as an investing cash flow in the acquirer's cash flow statement, is CU100 million.

Company B has CU40 million of debt and is acquired for CU60 million. Under these circumstances, the cost shown in the acquirer's cash flow statement is CU60 million.

However, acquiring Company B will also result in assuming a further CU40 million of debt when the acquired business is consolidated. From an economic perspective, these transactions are identical. However, this is evident only if an investor has information about movement in both cash and debt.

Consequently, many investors want to prepare an ‘economic cash flow statement’. Following application of the IAS 7 requirements, this should be a mathematical exercise that applies consistently as follows:

Economic cash flow statement	
Opening cash and financial liabilities (‘net debt’)	X
+/- Cash movements other than financing	X
+/- Non-cash changes in financial liabilities	X
Closing cash and financial liabilities (‘net debt’)	X

Application

Most entities elect to fulfil the disclosure requirement in paragraph 44A of IAS 7 by disclosing a reconciliation between the opening and closing balances in the statement of financial position for liabilities arising from financing activities[4]. This disclosure is referred to below as an ‘IAS 7 reconciliation’.

However, the IAS 7 reconciliations provided by entities do not always meet investor needs. This is for four main reasons:

Reason for failure to meet investor needs	Explanation
Inconsistency in definitions	Some entities base their IAS 7 reconciliation on a definition of ‘debt’ or ‘net debt’ that cannot be reconciled to the primary financial statements. Consequently, investors are unable to link items included in the

[4] Election available applying paragraph 44D of IAS 7. Such IAS 7 reconciliation will include the changes in liabilities identified in paragraph 44B.

	reconciliation to the statement of financial position and the statement of cash flows.
Insufficient disaggregation	Some entities do not disaggregate their IAS 7 reconciliation to a level that enables investors to link items included in the reconciliation to the balance sheet and the cash flow statement. Examples of insufficient disaggregation relate both to the type of financial liability (ie the opening and closing position on the IAS 7 reconciliation), and to the non-cash movements (ie the reconciling items). For some entities, insufficient disaggregation includes excessive use of 'other' categories.
Inadequate explanation	Some entities do not explain items in the IAS 7 reconciliation or cash flow statement that—in their circumstances—are critical to an investor's understanding. Examples of inadequate explanation include: - how items such as hedging instruments, interest paid or accrued, and cash collateral have been treated; - the nature of items such as 'change in financial liabilities', 'movement in investments'; 'other financial liabilities' or 'miscellaneous' that appear in the cash flow statement or IAS 7 reconciliation
Presentation/disclosure errors	For example, some entities disclose: - cash flow movements in their IAS 7 reconciliation that are different from identical items in the cash flow statement; - opening balances in the IAS 7 reconciliation that are different from identical items in financial instrument disclosures and/or in the balance sheet; - double counting of items – for example, the same cash movement appearing within two-line items in the IAS 7 reconciliation.

Summary

In summary, application of the requirements does not always satisfy the disclosure objective set out in paragraph 44A of IAS 7. Furthermore, application of the requirements appears to be inconsistent across entities. This is because, in some cases, application of the requirements has been effective in meeting investor information needs but, in others, it has not.