Review of the application of IAS 7 *Statement of Cash Flows* by selected Irish equity issuers

October 2014

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EXECUTIVE SUMMARY

The level of compliance with the presentational requirements of IAS 7* Statement of Cash Flows *by the equity issuers selected was satisfactory

There are a number of areas where the presentation of cash flows does not result in information that is readily comparable between equity issuers

The application by issuers of alternative financial reporting treatments permitted by IAS 7 highlights the need for users to carefully study the particular treatments adopted in specific instances

Issuers produce various non-accounting standard based cash flow statements and the measurement basis used for these Alternative Performance Measures varies

SECTION 1 – BACKGROUND INFORMATION

1. Background and context

A statement of cash flows is one of the four primary financial statements that an entity is required to produce. In simple terms the statement of cash flows is a financial statement that shows how an entity generates and uses cash and cash equivalents. In the opinion of many users of financial reports, it is the most important and useful of the four primary financial statements. The relevant accounting standard for Irish equity issuers is IAS[1] 7 *Statement of Cash Flows* which requires the entity to classify cash flows during the reporting period into operating, investing, and financing activities.

The statement of cash flows is useful in:

- determining the short-term viability of an entity;
- providing information as to how the entity conducts its operations;
- providing insight into the ability of the entity to provide returns to investors; and
- understanding the changes in the financing of the entity.

Preparers of IFRS[2] financial statements exercise judgement in the preparation of financial statements with the result that reported amounts may not be comparable from one entity to another. Users of such financial statements need to study the financial statements carefully to fully understand the entity's cash flows and preparers need to provide sufficient disclosures to aid users' understanding.

IAS 7 provides reporting entities with a number of options in the presentation of the cash flow statement. A summary of these alternatives is set out in Appendix I to this document.

Certain reporting entities provide additional cash flow information in the annual report outside the IFRS-based financial statements such as:

a) a summarised cash flow;

b) a measure of "free cash flow"; and

c) a reconciliation of cash flows to a measure of "net debt"

These non-IFRS measures can be defined differently by reporting entities.

In addition, the presentation style applied by reporting entities varies which reduces the comparability of cash flow statements between reporting entities.

2. Purpose of this document

IAASA (the accounting enforcer in Ireland) has previously engaged with issuers on IAS 7 related matters which resulted in a number of undertakings for improvements being provided. A summary of some of these is provided in Section 2. As a consequence of these past interactions, IAASA has undertaken a thematic study of the 2013 annual financial reports of ten selected equity issuers to determine those issuers' approach to the application of IAS 7.

While this document is primarily directed at the users of periodic financial statements of issuers falling within IAASA's financial statement review remit, users, preparers, auditors, and other stakeholders of the financial statements of entities not within IAASA's financial statement review remit may also find it of interest.

This document has been prepared to highlight for users of Irish equity issuers' annual financial statements the areas where divergent, but not necessarily non-compliant, approaches have been adopted in practice. The document also aims to stimulate debate amongst stakeholders as to whether

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[1] International Accounting Standard
[2] International Financial Reporting Standards

and, if so, how existing approaches could be modified to provide enhanced comparability with similar information about other entities and with similar information about the same entity for another reporting period.

3. Selection methodology

The ten annual financial reports of equity issuers sampled for review were selected judgementally and are set out in Appendix II to this document. The objective of the sample was to cover a cross section of industry sectors and to review issuers ranging from the larger issuers in terms of market capitalisation to smaller sized entities.

The review comprised a desk top review of the published annual financial statements and thus no additional information was sought from issuers. Our review did not extend to verifying the accuracy of amounts presented in the selected issuers' financial statements. Rather, the review was confined to presentation and disclosure matters and did not examine measurement issues.

4. Key findings and recommendations

In general, the level of compliance with the presentational requirements of IAS 7 by the selected issuers was satisfactory. This conclusion is not unexpected given that the Statement of Cash Flows is one of the primary statements in issuers' annual financial statements, the financial reporting standard has been in place, substantially unchanged, for a number of years, and the relatively uncomplicated requirements of IAS 7.

However, despite the good quality disclosures by many issuers, there are a number of areas where the presentation of cash flows does not result in information that is readily comparable between issuers. Our findings show a lack of consistency in the application of IAS 7 but this does not necessarily mean that issuers did not comply with the Standard. We would encourage more prescriptive definitions to be provided by the accounting standard setter (the IASB[3]) and will be sharing our findings with them as part of their deliberations on the matter (see 5 below). For example, and as set out in more detail in Section 2 of the document, the selected issuers differed in:

a) their approach to the presentation of operating cash flows on the face of the cash flow statement or in the related notes;

b) their classification of interest paid as a cash outflow from operating activities or as a cash outflow from financing activities;

c) the level of disaggregation regarding the components of certain financing activities on the face of the cash flow statement;

d) whether or not an accounting policy for cash and cash equivalents was disclosed.

Arising from the results of this thematic review, IAASA intends to correspond with a small number of issuers in respect of the presentation of cash flows and to secure improvements to future disclosures where necessary.

IAASA believes that it would be aid users' understanding of cash flow statements if cash flow related Alternative Performance Measures ('APMs'):

a) were more fully defined;

b) were clearly reconciled to the applicable IAS 7 based measure; and

c) included a clear statement of the rationale for their use.

[3] International Accounting Standards Board

A number of selected issuers presented a summarised cash flow, in addition to the IAS 7 based cash flow statement. Certain selected issuers presented free cash flow amounts as APMs but, varying definitions as to what constitutes “free cash flow” were used.

This document is limited to consideration of aspects of reporting entities’ cash flow statements. The other components of a full set of financial statements (income statement, statement of financial position, statement of changes in equity, notes, and comparative information) are outside the scope of this document. However, readers are referred to the results of the study IAASA performed on issuers’ compliance with the requirements of the financial reporting standard dealing with the Income Statement - *Commentary on the Application of Certain Aspects of IAS 1* Presentation of Financial Statements *by Selected Irish Equity Issuers* (October 2013).[4]

5. International developments

The IASB is undertaking a broad-based initiative to explore how disclosures in IFRS financial reporting can be improved. The aim is to develop a disclosure Standard(s) to replace three current Standards: IAS 1 *Presentation of Financial Statements*, IAS 7 *Statement of Cash Flows* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

The IASB is working towards establishing principles:

a) for the notes to the financial statements, including establishing the objective and boundaries of the notes and principles for organising, placing, formatting and linking information; and

b) that apply to the information in a complete set of IFRS financial statements, including non-IFRS financial information and comparative information.

Other stakeholders, such as the European Financial Reporting Advisory Group (‘EFRAG’) and the Accounting Council of the UK’s Financial Reporting Council (‘FRC’) are engaged in projects examining IAS 7.

[4] Available in e book format at http://www.iaasa.ie/publications/IAS1/ebook/view.html#/0 and in PDF format at http://www.iaasa.ie/publications/IAS1/ebook/Presentation_of_Financial_Statements_10-2013.pdf

SECTION 2 – PREVIOUS IAASA ACTIVITY RELATING TO CASH FLOW STATEMENTS

1. Introduction

As part of its programme of examining the annual and half-yearly financial statements of issuers, IAASA has previously engaged with certain issuers regarding IAS 7-related matters.

This Section summarises such engagements arising from our annual examination programmes (item 2 below), and our annual *Observations* and thematic examination documents (item 3 below).

2. IAASA examinations

As part of our annual examination programmes, cash flow related matters have been raised with equity issuers. Table 1 below sets out examples of such matters and the outcome of the examination.

TABLE 1

	Matter raised	Outcome
1.	Definition, composition and reconciliation of non-IFRS measures such as "free cash flow", "net cash outflow" and "net debt"	The directors provided undertakings to provide definitions of and reconciliations for non-IFRS measures in future annual reports
2.	Reconciliation of amounts included in the non-IFRS-based summarised cash flow to the IAS 7-based cash flow statement	The directors provided undertakings to expand the narrative disclosures for the summarised cash flow statement in future annual financial statements It was agreed that the expanded narrative disclosures would be such as to enable users to identify any differences between the summarised cash flow and the IAS 7-based cash flow statement thereby enabling users to reconcile the two statements
3.	Reconciliation of non-IFRS measures included in the summarised cash flow statement such as "free cash flow" and "net cash inflow"	The issuer provided reconciliations
4.	Definition of "free cash flow" and reconciliation of non-IFRS measures included in the annual report to the IAS 7-based cash flow statement	The directors provided undertakings to include definitions of any non-IFRS measures and to provide reconciliations thereof to the nearest IFRS-based measure
5.	Treatment of non-cash transactions and reconciliation of amounts in cash flow statement to amounts disclosed in related notes including reconciliation of Cash and Cash Equivalents amounts in cash flow statement to amounts presented in Statement of Financial Position	The directors provided undertakings to distinguish between cash and non-cash transactions in the related notes and to amplify the components of Cash and Cash Equivalents in future financial statements
6.	Treatment of non-cash transactions	The directors provided undertakings to provide enhanced disclosures in future financial statements
7.	Distinction between financial assets that are Cash and Cash Equivalents rather financial assets held for investment or other purposes [IAS 7.7]	Issuer provided undertakings to distinguish between these items

While this Paper is limited to equity issuers, IAASA has engaged with fund and debt issuers on cash flow statements. Table 2 below provides an overview of IAASA's earlier interactions with those issuers.

TABLE 2

Debt and closed-ended fund issuers' cash flow statements
This thematic examination is limited to the application of IAS 7 by equity issuers. However, IAASA has also previously engaged with closed-ended fund ('CEF') and debt issuers on cash flow related matters. Matters identified and rectified by such issuers as a result of an IAASA examination included: ▪ inappropriate netting of transactions in the cash flow statement, particularly regarding loan note issued and redemptions; ▪ significant non-cash items incorrectly included in the cash flow statement and failure to disclose significant non-cash transactions in the notes [IAS 7.43 refers]; ▪ failure to provide separate disclosure of interest and dividends paid and received; ▪ cash flow statement based on parent entity amounts rather than on a consolidated basis; ▪ incorrect comparative amounts presented; ▪ failure to present the effect of foreign exchange movements on cash and cash equivalents in the cash flow statement; and ▪ errors in the presentation of tax receipts and payments.

3. IAASA publications

Each year IAASA publishes *Observations on Selected Financial Reporting Issues* which seek to assist issuers' management and those charged with issuers' governance in the preparation of high quality financial reports by offering observations on selected financial reporting issues to coincide with the preparation of issuers' annual financial statements. In addition, IAASA has published a number of documents setting out findings from thematic examinations.

Readers' attention is drawn to the following matters included in such documents.

a) Alternative performance measures

In 2012, IAASA issued recommendations for equity issuers' on the use of APMs which were contained in a paper titled *Alternative Performance Measures – A Survey of their Use together with Key Recommendations*. The purpose of that publication was to identify and describe the most common financial APMs presented in equity issuers' annual reports and to identify key recommendations which, if applied, should enhance users' understanding of the performance, financial position and cash flows and enable better comparability across issuers.

[Item 5 on page 5 of IAASA's 2013 *Observations* document refers].

In this regard, readers' attention is drawn to our publication *Alternative Performance Measures – A Survey of their Use together with Key Recommendations* (November 2012)[5,6].

b) Cash flow statements

Paragraph 10 of IAS 1 *Presentation of Financial Statements* states that a complete set of financial statements comprises:

(i) a statement of financial position;

(ii) a statement of profit or loss and other comprehensive income;

(iii) a statement of changes in equity;

(iv) a statement of cash flows; and

(v) accompanying notes, including accounting policies.

IAS 7 states that the statement of cash flows is an integral component of an entity's financial statements [IAS 7.1] and sets out the requirements for the presentation of same. In its financial statement examination activities, IAASA has observed instances where certain issuers' cash flow statements did not comply with IAS 7 in all respects. Given its importance as a primary statement, directors are expected to ensure that cash flow statements are free from error.

[Item 6 on page 11 of IAASA's 2012 *Observations* document refers].

[5] Available at http://www.iaasa.ie/publications/APM2012.pdf

[6] IAASA's APM Paper recommended that, where APMs are presented, management apply the following recommendations:

(a) explain the reason for the presentation of each APM;
(b) provide a clear definition of each APM used;
(c) provide an explanation of the basis for the calculation of each APM including details as to why selected APMs exclude certain items. The reasons for the adjustments should be clearly explained;
(d) provide a reconciliation of each APM to the relevant IFRS data, where applicable;
(e) include a comparative measure for all reported APMs;
(f) disclose all APMs used within a single location in the annual report where possible, making it easier for users to assess the performance measures as a whole;
(g) avoid the preparation and presentation of APMs in a manner that has the potential to detract from, or conflict with, the information provided in the financial statements; and
(h) avoid the presentation of APMs in a manner that gives them inappropriate prominence over the IFRS measures.

SECTION 3 – DETAILED FINDINGS

The following are the principal findings arising from this thematic review:

1. Positioning of the statement of cash flows

Requirements of IAS 1 *Presentation of Financial Statements*

10 *A complete set of financial statements comprises:*

(a) a statement of financial position as at the end of the period;

(b) a statement of profit or loss and other comprehensive income for the period;

(c) a statement of changes in equity for the period;

(d) a statement of cash flows for the period;

(e) notes, ...

	Statement of Financial Position	Income Statement	Statement of Comprehensive Income	Statement of Changes in Equity	Statement of Cash Flows
Number of issuers presenting the primary statement as					
- First statement	2	8			
- Second statement		2	8		
- Third statement	8		2		
- Fourth statement				6	4
- Fifth statement				4	6

Of the ten selected equity issuers, the Statement of Cash Flows was either the last primary statement presented (six instances) or the second last primary statement presented (four instances). Given that many users feel that the Statement of Cash Flows is so important, it is worthy of note that none of the issuers have elevated its order above the Statement of Financial Position or the Income statements.

2. Presentation of a statement of cash flows

Requirements of IAS 7

10 *The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.*

11 *An entity presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its business ....*

All ten selected equity issuers reported cash flows during the year classified by operating, investing and financing activities as required by IAS 7.

3. Operating activities

<u>Requirements of IAS 7</u>

14 *Cash flows from operating activities are primarily derived from the principal revenue producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss. Examples of cash flows from operating activities are:*

(a) cash receipts from the sale of goods and the rendering of services;

(b) cash receipts from royalties, fees, commissions and other revenue;

(c) cash payments to suppliers for goods and services;

(d) cash payments to and on behalf of employees;

(e) cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;

(f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and

(g) cash receipts and payments from contracts held for dealing or trading purposes.

Some transactions, such as the sale of an item of plant, may give rise to a gain or loss that is included in the recognised profit or loss. The cash flows relating to such transactions are cash flows from investing activities. However, cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale as described in paragraph 68A of IAS 16 Property, Plant and Equipment *are cash flows from operating activities. The cash receipts from rents and subsequent sales of such assets are also cash flows from operating activities.*

15 *An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities ....*

It was in this area that the greatest diversity in financial reporting treatment was detected amongst the ten selected equity issuers.

Matters noted in this regard were that:

a) six issuers presented the composition of cash flows from operating activities on the face of the cash flow statement; the remaining four issuers presented that information in a note to the financial statements;

b) the starting point for determining the cash flows from operating activities was profit before tax (four issuers) or profit after tax (six issuers).

   In addition to the Cash Flows from Operations starting with either profit before tax or profit after tax, issuers also presented other profit measures in the cash flow statement:

   - trading profit;

   - operating profit before exceptional items; and

   - net cash inflow from operating activities before exceptional items.

c) three issuers presented the detailed movement on working capital on the face of the cash flow statement while the remaining seven issuers provided that information in a note to the financial statements;

   One issuer included its Share-Based Payment Expense in its calculation of the movement on working capital. The reason for this treatment was not readily apparent.

d) one issuer presented the cash flow movements relating to non-current assets in a note to the financial statements; and

e) two issuers provided a reconciliation of opening to closing net debt on the face of the cash flow statement.

While no apparent instances of material non-compliance with the requirements of IAS 7 were detected, the variation in presentation may impede the ability of users to compare the performance of issuers.

4. Investing activities

Requirements of IAS 7

16 *The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities. Examples of cash flows arising from investing activities are:*

(a) cash payments to acquire property, plant and equipment, intangibles and other long term assets. These payments include those relating to capitalised development costs and self constructed property, plant and equipment;

(b) cash receipts from sales of property, plant and equipment, intangibles and other long term assets;

(c) cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);

(d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

(e) cash advances and loans made to other parties (other than advances and loans made by a financial institution);

(f) cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);

(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge of an identifiable position, the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

Three of the selected issuers presented interest paid as a cash outflow from operating activities. Four of the selected issuers presented interest paid as a cash outflow from financing activities.

One of the selected issuers presented the cash flow associated with restricted cash balances as a cash flow from investing activities. Another selected issuer presented movements in restricted cash balances as a cash flow from financing activities.

The application of permitted alternative financial reporting treatments by issuers in this regard highlights the need for users to carefully study the particular treatments adopted in specific instances.

5. Financing activities

Requirements of IAS 7

17 *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 or 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.

Examples of cash flows presented as financing activities by the ten selected issuers included:

a) proceeds from issue of shares and purchase of own shares;

b) proceeds from bond issues, bank loan draw downs and other debt issues;

c) repayment of borrowings;

d) cash flows on finance lease obligations;

e) cash flows on restricted cash balances; and

f) dividends paid.

The level of disaggregation of the components of certain financing activities varied between issuers with some issuers aggregating the movements on interest bearing loans, borrowings and finance leases into a single line item on the face of the Cash Flow Statement and other issuers presenting a separate line item for each element thereof.

In each selected issuer where there was a non-controlling interest, dividends paid to equity holders of the issuer and dividends aid to non-controlling interest were presented separately.

6. Reporting cash flows from operating activities – direct and indirect method

Requirements of IAS 7

18 *An entity shall report cash flows from operating activities using either:*

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

19 *Entities are encouraged to report cash flows from operating activities using the direct method…..*

While IAS 7 encourages, but does not require, entities to report cash flows from operating activities using the direct method, none of the ten selected equity issuers did so; rather, all ten reported cash flows using the indirect method permitted by IAS 7.

7. Reporting cash flows from investing and financing activities & reporting cash flows on a net basis

Requirements of IAS 7

21 An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis.

Reporting cash flows on a net basis

22 Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

(a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity; and

(b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

....

24 Cash flows arising from each of the following activities of a financial institution may be reported on a net basis:

(a) cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;

(b) the placement of deposits with and withdrawal of deposits from other financial institutions; and

(c) cash advances and loans made to customers and the repayment of those advances and loans.

With few exceptions, issuers do not appear to have netted items in the cash flow statement.

In those very limited instances where items were described as "net", it was not readily apparent as to the gross amounts involved; it may be the case that the gross amounts were not significant.

8. Foreign currency cash flows

Requirements of IAS 7

25 Cash flows arising from transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

26 The cash flows of a foreign subsidiary shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.

28 .... the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the statement of cash flows in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

Eight of the ten selected issuers presented the foreign exchange gains/(losses) on cash and cash equivalents as part of the reconciliation of the cash and cash equivalents at the beginning and the end of the year. In the case of the other two issuers, it would appear that there was no such foreign exchange gains/(losses) on cash and cash equivalents to be reflected in the statement of cash flows.

9. Interest and dividends

<u>*Requirements of IAS 7*</u>

31 Cash flows from interest and dividends received and paid shall each be disclosed separately. Each shall be classified in a consistent manner from period to period as either operating, investing or financing activities.

32 The total amount of interest paid during a period is disclosed in the statement of cash flows whether it has been recognised as an expense in profit or loss or capitalised in accordance with IAS 23 Borrowing Costs*.*

33 Interest paid and interest and dividends received are usually classified as operating cash flows for a financial institution. However, there is no consensus on the classification of these cash flows for other entities. Interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of profit or loss. Alternatively, interest paid and interest and dividends received may be classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

34 Dividends paid may be classified as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, dividends paid may be classified as a component of cash flows from operating activities in order to assist users to determine the ability of an entity to pay dividends out of operating cash flows.

Interest income and interest received
All ten selected issuers recognised finance income in the year and all included the finance income recognised as a constituent part of the reconciliation of profit or loss for the year to operating cash flows.

However, while cash flows from interest received was disclosed separately in each instance, the classification adopted varied between the ten selected issuers:

a) eight issuers classified cash flows from interest received as investing cash flows; and

b) two issuers classified cash flows from interest received as operating cash flows.

Interest expense and interest paid
Four of the ten selected issuers paid interest during the period and each classified those payments as operating cash flows.

Dividends income and dividends received
One issuer had dividend income during the period and the cash dividend was classified as operating cash flows.

Dividends paid
Of the ten selected equity issuers, nine disclosed dividend payments. The tenth issuer did not pay any dividends.

All those nine issuers classified dividends paid as financing cash flows. All five issuers with non-controlling interests presented dividends paid to equity holders of the entity and dividends paid to non-controlling interests separately on the face of the Statement of Cash Flows.

10. Taxes on income

<u>Requirements of IAS 7</u>

35 Cash flows arising from taxes on income shall be separately disclosed and shall be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.

All ten selected equity issuers separately disclosed income tax payments/refunds as a separate line item after the sub-total for net cash generated from operations and before the sub-total for net cash generated from operations.

None of the ten selected equity issuers specifically identified cash flows arising from taxes on income as part of financing or investing activities.

11. Investments in subsidiaries, associates and joint ventures

<u>*Requirements of IAS 7*</u>

37 When accounting for an investment in an associate or a subsidiary accounted for by use of the equity or cost method, an investor restricts its reporting in the statement of cash flows to the cash flows between itself and the investee, for example, to dividends and advances.

38 An entity which reports its interest in a jointly controlled entity (see IAS 31 Interests in Joint Ventures*) using proportionate consolidation, includes in its consolidated statement of cash flows its proportionate share of the jointly controlled entity's cash flows. An entity which reports such an interest using the equity method includes in its statement of cash flows the cash flows in respect of its investments in the jointly controlled entity, and distributions and other payments or receipts between it and the jointly controlled entity.*

From the information provided in the selected issuers' annual financial statements, it appears that the selected issuers' annual financial statements met the requirements of IAS 7 in this regard.

12. Changes in ownership interests in subsidiaries and other businesses

<u>*Requirements of IAS 7*</u>

39 The aggregate cash flows arising from obtaining or losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities.

40 An entity shall disclose, in aggregate, in respect of both obtaining and losing control of subsidiaries or other businesses during the period each of the following:

(a) the total consideration paid or received;

(b) the portion of the consideration consisting of cash and cash equivalents;

(c) the amount of cash and cash equivalents in the subsidiaries or other businesses over which control is obtained or lost; and

(d) the amount of the assets and liabilities other than cash or cash equivalents in the subsidiaries or other businesses over which control is obtained or lost, summarised by each major category.

41 The separate presentation of the cash flow effects of obtaining or losing control of subsidiaries or other businesses as single line items, together with the separate disclosure of the amounts of assets and liabilities acquired or disposed of, helps to distinguish those cash flows from the cash flows arising from the other operating, investing and financing activities. The cash flow effects of losing control are not deducted from those of obtaining control.

42 The aggregate amount of the cash paid or received as consideration for obtaining or losing control of subsidiaries or other businesses is reported in the statement of cash flows net of cash and cash equivalents acquired or disposed of as part of such transactions, events or changes in circumstances.

42A Cash flows arising from changes in ownership interests in a subsidiary that do not result in a loss of control shall be classified as cash flows from financing activities ....

42B Changes in ownership interests in a subsidiary that do not result in a loss of control, such as the subsequent purchase or sale by a parent of a subsidiary's equity instruments, are accounted for as equity transactions (see IFRS 10) .... Accordingly, the resulting cash flows are classified in the same way as other transactions with owners described in paragraph 17.

From the information provided in the selected issuers' annual financial statements, it appears that the selected issuers' annual financial statements met the requirements of IAS 7 in this regard.

13. Non-cash transactions

> *Requirements of IAS 7*
>
> *43 Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows ....*

From the information provided in the selected issuers' annual financial statements, it appears that investing and financing transactions that did not require the use of cash or cash equivalents had been excluded from the statement of cash flows.

However, the converse was not readily apparent. For example, in one instance, the notes to an issuer's annual financial statements disclosed the amount of cash settlements of claims as part of the movement on provisions. However, the cash flow statement did not disclose those cash outflows. Rather, the movement on the provisions balance was included in the cash flow statement.

14. Components of cash and cash equivalent

> *Requirements of IAS 7*
>
> *45 An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts in its statement of cash flows with the equivalent items reported in the statement of financial position.*
>
> *46 In view of the variety of cash management practices and banking arrangements around the world and in order to comply with IAS 1* Presentation of Financial Statements*, an entity discloses the policy which it adopts in determining the composition of cash and cash equivalents.*

Seven of the selected issuers provided an analysis of the components of cash and cash equivalents in the notes to cash flow statement; in the case of the remaining three issuers the cash and cash equivalents amount was shown as a line item on the face of the statement of financial position.

Nine of the ten selected issuers disclosed the policy adopted in determining the composition of cash and cash equivalents. The remaining issuer provided no such disclosure.

Of those nine selected issuers, six specifically referenced the fact that cash and cash equivalents comprised cash, deposits and highly liquid investments with original maturities of three months or less, and bank overdrafts.

15. Other disclosures

> Requirements of IAS 7
>
> *48 An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the group.*
>
> *49 ....*
>
> *50 Additional information may be relevant to users in understanding the financial position and liquidity of an entity. Disclosure of this information, together with a commentary by management, is encouraged and may include:*
>
> *(a) the amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities;*
>
> *(b) [deleted]*
>
> *(c) the aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity; and*

> (d) *the amount of the cash flows arising from the operating, investing and financing activities of each reportable segment (see IFRS 8* Operating Segments*).*

One issuer disclosed restricted cash balances which are held for regulatory purpose due to the nature of the issuer's activities in a regulated industry.

In addition, a number of the selected issuers provided cash flow information in the narrative accompanying the financial statements:

a) two issuers presented, in addition to the IAS 7 mandated Statement of Cash Flows, a Summarised Cash Flow Statement in the Finance Review;

b) five issuers presented free cash flow amounts and commentary.

   Free cash flow was variously defined as:

   - '*Cash generated from operating activities less net capital expenditure (purchases of fixed assets exclusive of finance lease debt raised less proceeds from disposals) plus or minus net interest received/paid*';

   - trading profit adjusted for net depreciation, movement in average working capital purchase of non-current assets, capital expenditure, pension contributions paid less pension expense, net finance costs and income taxes paid;

   - earnings before finance costs, income taxes, depreciation, amortisation and exceptional items adjusted for non-cash items, movement in working capital, movement in provisions, capital expenditure (net) pension contributions, finance costs and income taxes paid;

   - EBITDA adjusted for exceptional items, cash interest expense, working capital change, current provisions, capital expenditure, changes in capital creditors, tax paid, sale of fixed assets and other;

   and, in one instance, was not defined.

   A reconciliation of free cash flow (a non-IFRS measure) to an IFRS measure of cash flow (e.g. cash generated from operations) was typically provided by these issuers.

c) issuers reported that their financial key performance measures included cash flow measures. These measures included:

   - Operating Cash Flow which was defined by the issuer as '*cash profits less tax payments and capital expenditure ... adjusted for working capital movements*'; and

   - Business Operating Cash Flow which was defined by the issuer as trading profit adjusted for net depreciation, movement in average working capital and purchase of certain non-current assets.

d) one issuer presented (i) a Reconciliation of Profit before Tax to Free Cash Flow; (ii) Significant Cash Flow Movements in the Year ; (iii) Significant Movements in Gross Debt in the Year; and (iv) Debt Repayment schedule, all in graphic format. Another issuer provided a Reconciliation of Opening Net Cash to Closing Net Cash in graphic format.

e) two issuers presented measures of Net Debt.

f) seven issuers provided disclosure in the notes to their financial statements regarding undrawn borrowing facilities including quantification of such facilities. The remaining three issuers provided no disclosure in this regard; it is not apparent whether or not those three issuers had undrawn borrowing facilities.

APPENDIX I

OPTIONS AVAILABLE UNDER IAS 7 TO ENTITIES IN THE PRESENTATION OF THE CASH FLOW STATEMENT

	Paragraph	
1.	IAS 7.18	An entity reports cash flows from operating activates using either: a) The direct method – major classes of gross cash receipts and gross cash payments are disclosed; or b) The indirect method – profit or loss is adjusted for the impact of transactions of a non-cash nature, and deferrals or accruals of past or future operating cash receipts or payments and items of income or expense related to investing or financing activities.
2.	IAS 7.19	Entities are encouraged to report cash flows using the direct method.
3.	IAS 7.22	Cash flows arising from the following operating, investing or financing activities: a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity; and b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short may be reported on a net basis.
4.	IAS 7.31 – IAS 7.33	Cash flows from interest and dividends received and paid shall be classified in a consistent manner from period to period as operating, investing or financing activities. There is no consensus on the classification of these cash flows for non-financial institution entities. Interest paid and interest and dividends received may be classified as operating cash flows; alternatively, interest paid and interest and dividends received may be classified as financing cash flows and investing cash flows respectively.
5.	IAS 7.34	Dividends paid may be classified as a financing cash flow; alternatively, dividends paid may be classified as a component of cash flows from operating activities.
6.	IAS 7.36	Taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the tax cash flow is classified as an investing or financing activity as appropriate.

APPENDIX II

EQUITY ISSUERS UNDER IAASA'S FINANCIAL REPORTING EXAMINATION REMIT SELECTED FOR INCLUSION IN THIS THEMATIC REVIEW

	Issuer	Reporting date
1.	Aer Lingus Group plc	31 December 2013
2.	CRH plc	31 December 2013
3.	Datalex plc	31 December 2013
4.	Dragon Oil plc	31 December 2013
5.	FBD Holdings plc	31 December 2013
6.	Greencore Group plc	27 September 2013
7.	Kerry Group plc	31 December 2013
8.	Kingspan Group plc	31 December 2013
9.	Paddy Power plc	31 December 2013
10.	Smurfit Kappa Group plc	31 December 2013