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Dear Andrew,

FRC Discussion Paper *Improving the Statement of Cash Flows*

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the FRC's discussion paper *Improving the Statement of Cash Flows* (herein referred to as the 'DP').

We welcome the opportunity to comment on the DP proposals. Because we have not completed in-depth outreach efforts on all the issues discussed in the DP, we share our tentative views on selected DP suggestions.

Objective of cash flow statement

In the DP it is suggested to shift the current objective towards a statement of cash flows that shall mainly serve an assessment of the entity's liquidity and the financial structure of the entity. We do not support this suggestion.

In our view, the statement of cash flows derives from a stewardship purpose by depicting how the management generated inflows of cash and equivalents of cash and how it used those liquid resources during the reporting period. In this way it helps to better understand the performance of the entity as it allow for assessing the quality of reported earnings. Certainly, this cash flow information can also be of help in the context of other financial assessments, e.g. to gain more insights about the entity's liquidity and to support prediction efforts regarding the projection of future cash flows of the entity. Nonetheless, we do not think that a statement depicting historical cash flows has its main objective in providing information to whether the entity is likely to generate sufficient future cash inflows to meet its liabilities as they fall due. Similarly, we think that the capability of the statement of cash flows to provide insights to the financial structure of the entity is limited and should not be considered as the second main objective.

A statement of cash flows that should serve the main objectives as proposed in the DP would, in our view, need a fundamental rethink about is content, structure and classification.

Positive definition of 'operating activities'/'operating'

Generally, we think it would be useful if a positive definition could be determined for 'operating activities'. Nonetheless, we think that it will be difficult to achieve common agreement on such a single definition because the term 'operating' is linked with very different meanings and interpretations among international constituents. Some constituents might wish to align the notion of operating cash flow with the concept of free cash flow that is used in the valuation business. Other constituents might consider operating cash flows as the depiction of a sustainable measure excluding unusual or infrequently occurring cash transactions. Even the DP does not provide a proposal of such a definition and remains, in our view, too vague regarding the meaning of 'operating activities'.

Furthermore, any categorisation approach will inevitably require a residual category. Therefore, we think that, rather than developing a positive definition of operating activities, it would be more useful to develop a more structured approach regarding the classification of cash inflows and outflows. This should ideally enable a user to compute its individually adjusted measure of operating cash flow of the entity. In this context, we think improvements could be achieved if some guidance was provided regarding the depiction and classification of cash flows considered to be unusual or occurring infrequently, cash flows considered not being as part of an entity's core business, and other cash flows with a potential to dilute the users' prediction of sustainable cash flows.

If the IASB developed a subtotal measure of operating income for the statement of profit or loss as part of the Primary Financial Statements project, we agree with the view expressed in the DP that it would be important to use the same notion and meaning of 'operating activities' for the statement of cash flows.

Classification of capital expenditure

Generally speaking, we see some merits of categorising capital expenditure cash flows as part of operating activities, especially if the purpose is to align the net operating cash flows with the concept of free cash flow of the entity. Nonetheless, in light of the DP suggestions it is not overly clear to us what other cash flows would remain part of the investing category and which cash flows would also have to move to the operating category. For example, it is not clear to us how the DP proposals would treat inflows or outflows of cash arising from strategic shareholdings and participations. In other words, as the DP does neither provide a definition for ‘investing activities’ nor ‘operating activities’, it is difficult to evaluate the capital expenditure reclassification suggestion. We think it is necessary to develop a more robust concept for the distinction of cash flows between operating and investing and for how the distinction would serve the purpose of assessing the entity’s liquidity.

Offsetting and depiction of operating cash flows

The suggestion in the DP would permit a very high degree of offsetting for operating cash flows that effectively results in reporting a single net operating cash flow (except for inflows and outflows of cash for capital expenditure), as is illustrated in the recast example in appendix B of the DP. According to the DP, the entity would be required to disclose particularly significant cash inflows and outflows from operating activities or the changes in related working capital items in the notes.

Firstly, it is not clear to us why the DP suggests that an entity should report particularly significant cash inflows and outflows of cash from operating activities in the notes but not on the face of the primary financial statements. We question whether this suggestion is derived from a view that the computation quality of cash flow measures in the notes is different compared to the information reported in the notes. We do not support such a view as quantitative measures must have the same reporting quality, regardless of whether they are presented as part of the primary financial statements or disclosed in the notes. Thus, we think that, if the entity provides amounts of particularly significant cash flows from operating activities, the information should be reported on the face and not as part of the notes.

Secondly, in case the entity does not provide amounts of particularly significant cash inflows and outflows from operating activities, the DP suggests that the entity must disclose changes in related working capital items (of those particularly significant cash flows). The rationale for such a disclosure objective is not clear to us, but would be crucial in order to evaluate the level of information needed and the related cost for the entity to compile the disclosures. The recast example does not provide any clarity in this regard.

Overall, we remain concerned whether the DP proposals would address the cost/benefit issues that were raised by constituents in light of the IASB proposals in its former Financial Statement Presentation project regarding the disaggregation and depiction of cash inflows and outflows from operating activities.

Cash vs. cash equivalents

According to the DP proposals, the statement of cash flows should report inflows and outflows of cash, rather than cash and cash equivalents. This proposals is based on the view that the description of 'cash equivalents' in IAS 7 achieves the doubtful distinction in being both arbitrary and subjective and therefore undermines the comparability.

While we see some merits in the suggestion that maturity bright lines result in arbitrary judgement, it is not overly clear to us whether the discussion paper would, in consequence, also propose a new and broader definition of 'cash' for IFRSs. Thus, further clarification seems necessary before we are prepared to evaluate the DP proposal. For example, it seems unclear how the DP suggestion would treat transactions with digital currencies, e.g. Bitcoin, that do not meet the definition of cash in IFRSs but become more and more popular in the digital age. Furthermore, we do not observe that the shortcomings about the current designation of cash equivalents as described in the DP are a relevant issue in practice.

If you would like to discuss our comments further, please do not hesitate to contact Holger Obst or me.

Yours sincerely,

Andreas Barckow
President