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Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Response to the FRC consultation on Improving the Statement of Cash Flows

The CFA Society of the UK (CFA UK) represents about 11,000 investment professionals working across the financial sector including asset managers, buy-side analysts, sell-side analysts and credit rating analysts, among others. For advocacy purposes in the field of financial reporting, these members are represented by the Financial Reporting and Analysis Committee (FRAC). The FRAC welcomes the opportunity to respond to the FRC's consultation on improving the Statement of Cash Flows.

More specifically, we would also like to comment in more detail on the following questions:

1. *Do you have any comments on the discussion of the usefulness of information about cash flows?*

   Investors attach a lot of importance to Cash Flow Statements, as it is the basis of much of the valuation work. One point that the FRAC would particularly like to highlight is that any element that would help investors to reconcile the Cash Flow Statement with the Balance Sheet and the P&L Statement would be particularly useful.

2. *Do you agree that notional cash flows should not be reported in the statement of cash flows, but that non-cash transaction should be transparently disclosed? If notional cash flows should, in your view, be reported, how would they be identified?*

   We do not believe that any non-cash transaction or notional cash flow should be included directly in the cash flow statement. Any such information should instead be referred to into the Notes and/or would be part of a separate net debt reconciliation that includes non-cash changes (e.g. related to forex translation) as well as the net effect of cash in/outflows.

3. *Do you agree that operating activities should be positively defined or described?*

   On balance, the FRAC believes that such a description would be useful to investors. Crucially, we believe that any definition should be coherent with that in the P&L Statement so that investors can logically reconcile the two. This could be complemented by a note reconciling operating cash flow to operating profit.

4. *Do you agree that capital expenditure should be reported within operating activities rather than as an investing activity, with sub-total drawn before capital expenditure, and disclosure of the extent to which capital expenditure represents 'replacement' or 'expansion'?*

   For the FRAC, the most important is that capital expenditure be clearly stated, irrespective of where it sits in the Statement. And whilst there might be some logic in including capital expenditures in operating activities, we do not see this as a benefit of sufficient significance to warrant a change on the current practice.

   Regarding the separation of maintenance and expansion capital expenditures, we believe that this would necessitate too many arbitrary judgements, rendering the split of limited usefulness.

5. *What are your views on the reporting of cash flows relating to financing liabilities?*

   The FRAC's main concern in this regard is that it is important that any interest payment included in the Cash Flow Statement be limited to strictly cash payment, i.e. exclusive of any notional payment. If such elements are included in the balance sheet debt, we would then like a table in the Notes that allows the reconciliation of this debt with the payments included in the Cash Flow Statement.

6. *Do you agree that tax is best dealt with in a separate section of the statement of cash flows?*

   We do not have a strong view as to the location of tax paid within the Cash Flow Statement, though we preferred it to stay as a separate line in, or just after, the operating section, so that you can see net cash flow from operations before the section on investment, i.e. what it was spent on. Most importantly, the FRAC believes it is essential for the actual tax paid to continue to be clearly identified within the Cash Flow Statement, as it is the only way to assess the real tax rate of any reporting entity.

7. *In your view, should the statement of cash flows report flows of cash or of cash and cash equivalents? How, in your view, should cash and/or cash equivalents be defined, and why?*

   We feel it is essential that whatever definition is used in the Cash Flow Statement be consistent with that used in the Balance Sheet i.e. cash and cash equivalents, as in present practice.

10. *Do you agree that the direct method statement of cash flows should be neither prohibited nor required?*

    From a theoretical point of view, the FRAC believes that a direct method would yield a useful Cash Flow Statement. However, we also believe that current accounting systems simply do not allow for this possibility. Therefore, at the moment, we do not believe that a genuine direct method of producing Cash Flow Statements is possible.

    As we are 'stuck' with an indirect method, we would reiterate that efforts are best concentrated on helping to make the Cash Flow Statement reconcilable with the Balance Sheet and the P&L Statement. This means that the cash flow statement should start with a number from the P/L, whether that be net income, as in US practice, or operating profit, which we hope will be defined in the IASB's primary statements project.

Yours sincerely,

Marietta Miemietz
Co-chair, Financial Reporting and Analysis Committee
CFA Society of the UK

Paul Lee
Co-chair, Financial Reporting and Analysis Committee
CFA Society of the UK

Will Goodhart,
Chief Executive
CFA Society of the UK

About CFA UK and CFA Institute

The CFA Society of the UK (CFA UK) represents the interests of more than 10,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

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