

ILAG

Investment & Life Assurance Group
The Practitioner Voice



LETTER OF COMMENT NO. 93

International Accounting Standards Board
30 Cannon Street
London
EC4M6XH

14 April 2009

Dear Sirs,

Discussion Paper 'Preliminary Views on Financial Statement Presentation'

The Investment and Life Assurance Group (ILAG) welcomes the opportunity to comment on this discussion paper.

ILAG is a trade body representing members from the Life Assurance and Wealth Management industries. ILAG members share and develop their practical experiences and expertise, applying this practitioner knowledge to the development of their businesses, both individually and collectively, for the benefit of members and their customers.

In summary, our main comments:

- propose that users should continue to have the option to provide a direct or indirect cash flow
- propose that cash flows are only prepared at the Group level and not at subsidiary level
- propose that there should be no detailed reconciliation done as is currently proposed
- support a more sensible approach to reporting that would enable faster production of information that is timelier to users rather than an approach that is creating substantial work for little benefit.

Our specific responses to the questions listed within the discussion paper are noted below.

If you would wish to discuss our response in more detail we would be happy to do so.

Yours faithfully

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Responses and comments to 'Preliminary Views on Financial Statement Presentation'

19 Paragraph 3.75 proposes that an entity should use a direct method of presenting cash flows in the statement of cash flows.

(a) Would a direct method of presenting operating cash flows provide information that is decision useful?

Whilst the information may be of use, its benefits must be weighed against the increased burden on companies of producing this information. Many general ledger systems are geared around a balance sheet and income statement; to incorporate direct cash flow reporting within this would require a fundamental rewrite of general ledgers and associated systems at substantial cost and effort (hence most people currently adopt an indirect method).

Timely cash flow information is a good indicator of the health of a business. However, publication of a statutory cash flow statement is unlikely to be timely (eg it could be up to 9 months after the end of the accounting period in the UK), hence the benefits of a direct cash flow approach are unlikely to justify the substantial costs.

Within groups, costs are often settled via a centralised purchasing function and reallocated to group entities via inter-company accounts. This would throw a veil over transactions with suppliers and inhibit the desired understanding of the drivers of cash flows. However, the alternative of having to track costs back to source, sometimes through multiple layers of reallocations, would be very onerous. For this reason there is a strong case for removing the need for subsidiaries to prepare cash flow statements and to only require a cash flow statement at a Group consolidated level. This would eliminate inter-company settlement issues and better reflect the way that cash is controlled within Groups.

For companies that have information in the public domain (listed companies) there is an advantage to providing a cash flow statement (although an indirect one is probably as beneficial as a direct one) but for all other companies this is an unjustified burden.

The additional information is most likely to be useful for understanding working capital and financing activities. However, it could also be misleading.

Working capital cash flows could be distorted by the settlement of a large balance either before or after the end of an accounting period. This distortion may simply be a matter of chance. On the other hand cash flows could be manipulated by advancing or delaying the settlement of a balance. This brings into question the usefulness of cash flows in the current period for understanding cash flows in futures periods.

The stated objective of enabling the user to understand the likely emergence of future cash flows can be better achieved by providing the user with an understanding of the nature of revenues, expenditure, assets and liabilities, ie their liquidity, the risks associated with them, accounting policies and the relationship between an item accruing and its conversion into cash. This can be better achieved by more targeted disclosure requirements for material balances, eg aged debtor/creditor analyses, financing arrangements.

The discussion paper specifically mentions the netting off of realised fair value gains and losses. This issue would be better and more efficiently addressed by amending IAS39.

- (b) **Is a direct method more consistent with the proposed cohesiveness and disaggregation objectives (see paragraphs 3.75-3.80) than an indirect method? Why or why not?**

Yes. However, it is indiscriminate and disproportionate. It requires that all lines from the statement of comprehensive income are disaggregated, without regard to materiality or relevance. This inflates the costs without a matching increase in benefits.

- (c) **Would the information currently provided using an indirect method to present operating cash flows be provided in the proposed reconciliation schedule (see paragraphs 4.19 to 4.45)? Why or why not?**

Implicitly the same information should be available. The increased detail may make the revised reconciliation less accessible to users.

20 What costs should the boards consider related to using a direct method to present operating cash flows (see paragraphs 3.81–3.83)? Please distinguish between one-off or one-time implementation costs and ongoing application costs. How might these costs be reduced without reducing the benefits of presenting operating cash receipts and payments?

We believe the costs to be very substantial. However, it is very difficult to be precise without working through the practicalities of implementing the direct method. Before the board commits to such an important change to reporting requirements, it is imperative that field testing is performed in order to gain a better understanding of the impact on businesses.

In practice most cash flows represent the settlement of debtor or creditor balance. The direct cash flow statement would require the preparer to look through these balances to their constituent parts. This presents three problems:

- (i) *Disaggregation of these balances*

One-off costs

Restructuring of the general ledger, purchase ledgers and sales ledgers to capture the information required. This may mean restructuring an existing ledger system or may even necessitate upgrading the accounting system. Both can be very time consuming and costly.

Ongoing costs

In the absence of a wholly automated solution, procedures inevitably become more complex. There would be an ongoing training cost, eg for new staff or for changes to categorisations. Processing of invoices would take longer with an associated cost.

There would be a greater number of balances to maintain, control, reconcile, audit and report on, with associated costs.

- (ii) *Apportionment of part payments or payments on account between different classes of income or expenditure*

In practice, balances are not always settled in full or are settled by means of regular payments on account. Where balances include a mix of outgoings and revenue a policy and a procedure would be necessary to determine which part of the balance was deemed to be settled and which part was deemed to be outstanding.

One-off costs

The design, documentation and implementation of new processes to allocate cash against components of a balance.

Ongoing costs

Operation and maintenance of the new processes.

(iii) *Tracing transactions through groups*

One-off costs

Design, documentation and implementation of new processes.

Ongoing costs

Operation and maintenance of the new process.

Question 23 Paragraph 4.19 proposes that an entity should present a schedule in the notes to financial statements that reconciles cash flows to comprehensive income and disaggregates comprehensive income into four components: (a) cash received or paid other than in transactions with owners, (b) accruals other than remeasurements, (c) remeasurements that are recurring fair value changes or valuation adjustments, and (d) remeasurements that are not recurring fair value changes or valuation adjustments.

(a) Would the proposed reconciliation schedule increase users' understanding of the amount, timing and uncertainty of an entity's future cash flows? Why or why not? Please include a discussion of the costs and benefits of providing the reconciliation schedule.

The amount of work involved in preparing this reconciliation would be significant (especially for a direct cash flow approach) and would require substantial rework of existing systems (underlying systems that feed into the general ledger and the general ledger itself). In addition this would create another burden on finance departments at a time-pressured point of the year. The benefit is likely to be very little for the vast majority of companies.

Whilst the information may be of use for some analysts, it makes little sense to provide this for companies other than those that are listed. For listed companies the question must be asked as to what benefits will this actually achieve. Analysts are interested in the future of a company rather than its past performance and a further breakdown of historical information probably does little to aid them. The increased disclosure makes it more difficult for entities to publish results in a timely manner.

(b) Should changes in assets and liabilities be disaggregated into the four components described in paragraph 4.19 of the DP? Please explain your rationale for any component you would either add or omit.

The current proposal requires a lot of information with little benefit arising from it. A further split just adds to the burden and will provide little benefit to the users of the accounts.

(c) Is the guidance provided in paragraphs 4.31, 4.41 and 4.44–4.46 of the DP clear and sufficient to prepare the reconciliation schedule? If not, please explain how the guidance should be modified.

The amount of work required in altering core systems and the general ledger to produce this information means that we are unable to prepare an example to determine any issues. It is, therefore, very difficult to establish whether the guidance is set at the right level.

Question 24 Should the boards address further disaggregation of changes in fair value in a future project (see paragraphs 4.42 and 4.43 of the DP or paragraphs below)? Why or why not?

Disaggregation should be employed if it provides users with better information. The current approach of forcing people to disaggregate will just increase the quantity of information but not the quality. The board should consider allowing people to disaggregate where it provides better information but not enforcing it. The current levels of disaggregation have probably gone too far and more thought should be given

to whether the current proposed level should be optional, ie only disclosed where it helps the reader of the accounts.

Question 25 Should the boards consider other alternative reconciliation formats for disaggregating information in the financial statements, such as the statement of financial position reconciliation and the statement of comprehensive income matrix described in Appendix B, paragraphs B10–B22? For example, should entities that primarily manage assets and liabilities rather than cash flows (for example, entities in the financial services industries) be required to use the statement of financial position reconciliation format rather than the proposed format that reconciles cash flows to comprehensive income? Why or why not?

The board should not consider any of the proposed reconciliations. For financial services the proposals are far too detailed and will provide little benefit to the users of our accounts. In addition, as users of the accounts, we believe the information is currently far too detailed and would support more timely information and key points rather than lots of detail.

Ends