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Chairman
Pdc N° 34

Paris, the 12th of May 2016

Mr Roger MARSHALL
Acting Chairman - EFRAG Board
35 Square de Meeûs
B-1 000 Bruxelles

Re: EFRAG's Short Discussion Series, the statement of cash flows issues for financial institutions

Dear Mr Marshall,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned Discussion Paper. These views result from the ANC's due process, involving all interested stakeholders.

ANC welcomes the EFRAG's approach aiming to proactively perform research on such issues which are part of or related to projects included in the IASB's research program.

As a general comment, ANC wishes to highlight its view considering the lack of relevance of the Cash Flows Statement (CFS) for Financial Institutions (FI). As part of its due process, ANC has set up a working group which observed/noted that not only the CFS was not a tool used by financial analysts for both banking and insurance sectors, but was also set aside by the preparers who monitor their own and major risks (such as liquidity risk) relying on several other indicators (see §11 hereafter). Hence, based on these observations, ANC would welcome any future amendment of IAS 1 aiming to exempt FI from providing CFS as currently designed.

According to ANC, this EFRAG's initiative is justified by (i) the fact that the information provided by the CFS has not been found useful and relevant as far as FI are concerned, and by (ii) the fact that IASB implicitly recognised that there is an issue regarding the relevance of this statement for FI. In the BC of

the ED, the IASB indeed acknowledges that some research needs to be undertaken to understand which consistent information should be highlighted from a CFS related to the financial sector ¹.

ANC considers the EFRAG's Discussion Paper as a constructive ground that could be improved by some additional considerations.

IAS 7 requires the disclosure of information about the cash flows of an entity as it is considered as useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows. Providing information that enables users to evaluate the changes in net assets of an entity, its financial structure and its ability to affect the amounts and timing of cash flows, as it is stated in paragraph 4 of IAS 7, does not imply that the CFS is the sole means to reach these objectives.

For FI, which also use cash as an underlying of their businesses, disclosing information about the collection of cash resources and their following uses can be helpful for users of their financial statements. Analysing the funding sources and uses through the assets arising from operating activities and through the related funding resources collected in the course of these activities would be useful, and it should be distinguished from structural transactions that are outside operating activities such as business combinations for instance.

Regarding banks, such information encompasses a description of the funding structure (including wholesale funding) of the reporting entity.

Information could be then provided on key sources of funding, funding sources showing major categories (such as capital markets and equity, retail, discretionary wholesale secured funding, financing vehicles...). ANC has observed some practices among French and other European banks that provides so-called "cash balance sheet" in their financial communication that could be used as a ground to develop such new disclosure in substitution of the CFS (see references in appendix 2)..

Furthermore, such disclosure should not be limited to a static view of the funding structure at the reporting date but could also include narrative or quantitative information on how it has evolved during the period distinguishing operating activities from structural transactions.

We also note that, according to IAS 7, information about the financial structure of the entity also includes its liquidity. Disclosures on liquidity risks are still required by IFRS 7 and could also be improved as recommended by EDTF by providing information on "how the bank manages its potential liquidity needs" as well as "a qualitative analysis of the components of the liquidity reserve held to meet these needs".

Understanding how cash flows are generated or collected and how they are used is also closely linked to the Asset and Liability Management. As far as IASB has decided to focus on disclosures as a first step of its research project on dynamic interest rate risk management, ANC recommends EFRAG to take an active part in defining these new disclosures so that they could be consistent with cash flow disclosure.

As regards to the insurance sector, the topic should be more specifically addressed. How to disclose in the notes to financial statements information about the collection of cash resources and their following uses

¹ Cf. ED Conceptual framework. BC4.109 The key argument in favour of defining elements for the cash flow statement is that it would emphasise the importance of cash flow information. The arguments against doing so are that:

(a) defining elements of cash flows may have unintended consequences and would not solve any known practical problem.
(b) defining elements of cash flows would imply that all entities should produce a statement of cash flows. Some argue that, as currently structured, cash flow statements do not provide useful information in the case of financial institutions. The IASB is researching the use of the statement of cash flows. Until that research is complete, it would be premature to consider whether to define elements for cash flow statements.
(c) the most obvious definitions of elements of cash flows may imply a preference for the direct method. It would not be appropriate to embed such a preference in the *Conceptual Framework* without conducting further research. (The IASB has no current plans to consider the introduction of a requirement for a direct cash flow statement.)

should also take into consideration the new disclosure that will be required from insurance entities as the coming new Insurance contracts standard (IFRS 4) will be applicable. ANC shares EFRAG's view that it is currently premature to develop specific proposals as the new disclosure requirements linked to IFRS 4 are still unclear.

For FI involved in both banking and insurance activities, consolidated disclosure could be completed by specific additional segmental information linked with a disaggregation of the consolidated balance sheet that would distinguish assets and liabilities arising from the two activities. It would help users of financial statements to better understand how cash is generated and used under the two different activities taking into account their respective specificities through an adequate presentation of the information based on the issues discussed above.

Regarding the possible alternatives presented by EFRAG in the Discussion Paper, ANC's views are the following:

- ANC supports alternative n°1, with caveats mentioned in the next paragraph, related to the inclusion of prudential disclosure in the financial statements. However, assuming alternative n°1 would be rejected by the IASB, the ANC would then recommend keeping unchanged the current IFRS requirements in this respect, considering that the amendments proposed through alternative n°2 do not provide significant useful improvements to the current financial statements and related disclosures.
- ANC understands from the Discussion Paper that EFRAG is in favour of disclosing in the notes to financial statements additional information already required in the regulatory framework (and then already disclosed as part of the Pillar III of Basel agreement, related to financial communication). Regulatory and prudential information do not meet the same requirements and therefore encompasses some differences (consolidated perimeter for e.g. can be different as controlled insurance undertakings are excluded from the prudential perimeter²). ANC questions the usefulness of such information in the notes to IFRS financial statements and consequently does not support the integration of specific prudential disclosure related to liquidity risks in these financial statements, or any assessment of prudential risks. . Furthermore, this approach would raise questions related to the audit of such disclosures by statutory auditors.

ANC's comments and answers to the questions raised by EFRAG are provided in the Appendix 1 below.

We hope you will find these comments useful and would be pleased to provide you with any further information you may require, or to take part to any working group you may launch to address this issue.

Yours sincerely,



Patrick de CAMBOURG

² I.e. included according to the equity method for the prudential perimeter and fully consolidated in the accounting perimeter.

APPENDIX 1

Question 1 - Usefulness of the statement of cash flows

The DP discusses the claim that, for some entities, the statement of cash flows in its current format has limited relevance. Do you think the claim is legitimate? If so, do you think that paragraph 3.12 appropriately identifies these entities?

11. ANC has set up a working group encompassing both preparers and users of financial statements (financial analysts) to discuss this issue and to raise questions about the relevance of the current Cash Flow Statement (CFS) for financial institutions (FI). The conclusions reached by this working group lead ANC to express the following views:
- It must be highlighted that preparers don't use CFS, nor as a financial performance measurement tool, neither as a tool for monitoring or managing risks related to the liquidity risk in banks, and even less as a tool for monitoring insurance companies' solvency issue.
 - Moreover, analysts don't use CFS at all, and they would rather be interested in additional information that could help to assess:
 - the liquidity risk in banks,
 - the capital adequacy constraints for these regulated industries, and the resulting impact on the ability of these entities to pay dividends,
 - the solvency in insurance companies.

It should be noticed that analysts already collect a wide range of information on liquidity risk and capital adequacy through specific prudential disclosures still issued by banks as required by the current regulation (Pillar III of Basel agreement), even if such information is disclosed outside the financial statements. When it comes to the insurance industry, a comparable source of information will be available as a result of the insurance regulation implementation. For instance, the new rules of "Solvency II" are mandatory from the beginning of 2016.

12. ANC does not fully share the EFRAG's views related to the scope described in §3.12: the CFS lack of relevance is not limited to banks collecting deposits as far as entities that fund their issuance of new loans by raising funds on the financial markets have the same concerns. It is more broadly the case for all entities with an established Asset and Liability Management process, even when they do not benefit from redeemable deposits resources. For the insurance sector, entities carrying non-life insurance commitments should also be included in the scope.

Question 2 - Possible alternatives

Chapter 3 discusses two alternatives: replacing the statement of cash flows for the identified entities with other requirements, or retain it with targeted improvements. Do you support any of these two proposals? If not, do you have other suggestions?

21. ANC supports alternative n°1 (exemption to provide any CFS for FI, and replacement by relevant disclosures):
- This approach would bring an appropriate answer to the issue implicitly raised by IASB in its Exposure Draft on the Conceptual Framework when it tentatively removed the CFS from the primary financial statements. In the Basis for Conclusions of its ED, the IASB indeed

acknowledges that some research needs to be undertaken to understand the use of the CFS for financial institutions³.

- Concerning the disclosures that would replace CFS in the financial statements of FI, please see our views in the answer to Question 3 here below. ANC is not convinced by the alternative models proposed in the Discussion Paper, in particular as regards the prudential framework, cf. § 3.16 and § 3.19 (see developments below, on the bank's section of our answer to Question 3)

22. ANC does not support alternative n°2 (please see explanations in our answer to Question 4).

Question 3 - Replacing the statement of cash flows

Assuming the statement is replaced by the identified entities, do you support the introduction of the new disclosures discussed in paragraphs 3.14 to 3.37? If not, what other requirements would you suggest to replace the statement of cash flows with?

31. Two sets of information are proposed in the EFRAG Discussion Paper as possible alternatives to the current CFS: information on liquidity and information on changes in assets and liabilities.

Both are encompassing prudential information already required outside the financial statements, such as disclosure related to High Quality Liquid Assets (HQLA), to the NSFR (Net Stable Funding Ratio) and to the LCR (Liquidity Coverage Ratio) Information on liquidity, or disclosure aiming to assess the variations of the regulatory capital like periodic changes on the Core Equity Tier One (CET1) and CET2.

This information is still provided publicly outside financial statements, through Pillar III disclosures. Since prudential conceptual approaches for classifying and measuring assets and liabilities do not fully converge with the accounting framework requirements on these issues (there are differences about the consolidation perimeter, the use of prudential adjustments, the definition of prudential own funds versus accounting equity...), ANC does not consider that they are useful and relevant for an understanding of the financial statements, despite the fact that users need them to assess the sustainment and the solvency of the reporting entity. ANC questions the usefulness of such information in the notes to IFRS financial statements and consequently does not support the integration of specific prudential disclosure related to liquidity risks in these financial statements.

32. **Common objective of cash flow disclosure:** IAS 7 Statement of Cash flows requires the disclosure of information about the cash flows of an entity as it is considered as useful in providing users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows. The objective of providing information that enables users to evaluate the changes in net assets of an entity, its financial structure and its ability to affect the amounts and timing of cash flows, as it is stated in paragraph 4 of IAS 7, does not imply that the CFS is the sole means to reach these objectives.

³ Cf. ED Conceptual framework. BC4.109 The key argument in favor of defining elements for the cash flow statement is that it would emphasise the importance of cash flow information. The arguments against doing so are that:
(a) defining elements of cash flows may have unintended consequences and would not solve any known practical problem.
(b) defining elements of cash flows would imply that all entities should produce a statement of cash flows. Some argue that, as currently structured, cash flow statements do not provide useful information in the case of financial institutions. The IASB is researching the use of the statement of cash flows. Until that research is complete, it would be premature to consider whether to define elements for cash flow statements.
(c) the most obvious definitions of elements of cash flows may imply a preference for the direct method. It would not be appropriate to embed such a preference in the *Conceptual Framework* without conducting further research. (The IASB has no current plans to consider the introduction of a requirement for a direct cash flow statement.)

For FI, which also use cash as an underlying of their businesses, it could be relevant to provide users of their financial statements with information about the collection of cash, distinguishing the different sources of funding, and then to provide information on how these resources have been allocated to financial assets .

Analysing the funding sources and uses of cash through the assets arising from operating activities and through the related funding resources collected in the course of these activities would be useful to assess how cash is managed as an underlying of the business. This information should be then distinguished from structural transactions that are outside operating activities; specific information could be disclosed about the funding of significant business combinations for instance.

33. Regarding banks, this type of information encompasses a description of the funding structure (including wholesale funding) of the reporting entity. Information could be then provided on key sources of funding, external funding sources showing major categories (such as capital markets and equity, retail, discretionary wholesale secured funding, financing vehicles...).

ANC has observed some practices among French and other European banks that provides “cash balance sheet” (also called “Funded balance sheet”, “Funding relationship” or “Funding sources and uses”...) in their financial communication. These “cash balance sheets” are built on the basis of adjusted IFRS balance sheet items, and the reporting entities provides specific notes of methodology describing how adjustments are performed such as, for instance, asset and liabilities compensation or reclassifications among funding sources (see references in appendix 2 hereafter).

Such funding relationships analysis could be used as a ground to develop a new disclosure in substitution of the current CFS. Furthermore, the static view provided through this “cash balance sheet” could be enhanced by adequate comments and also by additional dynamic information that would help users to understand how the funding structure has moved during the period.

34. ANC has also identified other disclosure than could meet IAS 7 objectives regarding the cash flows. Thus, the information on liquidity risk and Asset and Liability Management provides users with additional relevant information on how financial institutions generate cash flows and use these cash flows.

We note that, according to IAS 7, information about the financial structure of the entity also includes its liquidity. Disclosures on liquidity risks are still required by IFRS 7 but could also be improved as recommended by EDTF by providing information on “how the bank manages its potential liquidity needs” as well as “a qualitative analysis of the components of the liquidity reserve held to meet these needs”. This includes maturity analysis of assets and liabilities based on contractual maturity but it also includes how institutions manage the liquidity risk on financial assets and liabilities by taking into account behavioural assumptions (notably on core deposits), whereas IFRS 7 requires entities to disclose a maturity analysis of financial liabilities only and based on contractual maturities (cf. IFRS 7.39 and IFRS 7.B11C which requires to include demand deposits in the earliest time band). Indeed, as highlighted by EDTF in its 2012 report “tables setting out behavioural maturity profile based on models of customer behaviour under normal business conditions” is of interest to users.

35. Understanding how cash flows are generated or collected and how they are used is also closely linked to the Asset and Liability Management. The maturity analysis of assets and liabilities based on a behavioural profile could have some interaction with the interest rate risk management performed through Asset and Liability Management.

As far as IASB has decided to focus on disclosures as a first step of its research project on dynamic interest rate risk management (macro-hedge accounting), ANC recommends EFRAG to take an active part in defining related new disclosures so that they could be consistent with cash flow disclosure.

36. **As regard to the insurance sector**, EFRAG's Discussion Paper does not address in detail the issues that are specific to this industry.

ANC organized several interviews of financial analysts dedicated to the insurance sector. It has been noted that they mainly focus on solvency information (and not on liquidity risk, as it would be the case for banks), but also that key debates still exist about the concept of capital generation depending on whether users look to MCEV (Market Consistent Embedded Value) calculation, which is defined by the CFO forum, or to Solvency 2, which is defined by prudential authorities.

However, like previously mentioned for banks, ANC is not in favour of integrating a master piece of the insurance prudential data (Solvency II) in the notes to financial statements.

How to disclose in the notes to financial statements information about the collection of cash resources and their following uses should also take into consideration the new disclosure that will be required from insurance entities when the coming new Insurance Contracts standard (IFRS 4) will be applicable. IFRS 4 is expected to be finalized by the end of 2016 (indeed planned technical deliberations are finalized and the balloting process may start soon); in that context, ANC shares the analysis of EFRAG that it's premature to suggest changes for insurers as it is still unclear what will be required for insurance contracts.

37. **For FI involved in both banking and insurance activities**, consolidated disclosure about the collection of cash and how these resources have been used answers to an issue common to both activities as they share the use cash as an underlying of their businesses.

Nevertheless, this disclosure could be completed by specific additional segmental information. It could be based on a disaggregation of the consolidated balance sheet that would distinguish assets and liabilities arising from the two activities. Relevance of this segmentation could be argued by both a separate management and specific governance dedicated to each activity inside conglomerates. Such distinction is required in order to protect the interest of insurance policyholders, and is also linked to the supervision of insurance activities and banking activities by specific prudential authorities in Europe where these two activities are regulated. It would help users of financial statements to better understand how cash is generated and used under the two different activities taking into account their respective specificities through an adequate presentation of the information based on the issues discussed above.

Question 4 - Targeted improvements

Assuming that the statement is retained for the identified entities, do you support the targeted improvements in paragraphs 3.38 to 3.47?

41. ANC does not support alternative n° 2 for following reasons:

- The targeted improvements proposed in the EFRAG's Discussion Paper do not improve the CFS relevance when applied to FI, nor its usefulness for the management or for users,
- Furthermore, ANC does not understand the relevance of CFS tax effects adjustments,
- ANC considers that the costs/benefits analysis related to these proposed amendments appears to be clearly negative.

As a consequence, should the alternative n°1 being rejected, we would then advocate a status quo decision keeping unchanged the current CFS.

Question 5 - Separate financial statements

The DP discusses general issues with the statement of cash flows for the identified entities. Do you think that there are other issues specific to their separate financial statements? If so, what are they?

The cash flow statement is not required in the French separate financial statements of financial institutions. We have then no issue to rise regarding the separate financial statements.

APPENDIX 2

- HSBC Holdings plc Annual Report and Accounts 2014 – Page 168 – Sources of funding
- Barclays PLC Annual Report 2014 – Page 196 – Risk review – Funding risk
- Credit Agricole – Document de référence 2014 – p 221 – Bilan *cash* au 31 décembre 2014
- BNP PARIBAS – Document de référence et rapport financier 2014 – page 347 – Evolution du bilan financé
- GROUPE BPCE – Document de référence 2014 – page 167 – Bilan cash du groupe
- SOCIETE GENERALE – Communication financière - Résultats de l'année et du 4ieme trimestre 2015 – page 75 – Bilan financé

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