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Ms Sue Lloyd
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Our ref RD/288

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Dear Ms Lloyd

Tentative agenda decision *Demand Deposits with Restrictions on Use (IAS 7 Statement of Cash Flows)*

We appreciate the opportunity to comment on the IFRS Interpretations Committee (the Committee) tentative agenda decision (the TAD) *Demand Deposits with Restrictions on Use (IAS 7 Statement of Cash Flows)* published in the September 2021 IFRIC Update. We have consulted with, and this letter represents the views of, the KPMG network.

While we do not disagree with the conclusion in the specific fact pattern presented, we believe that the TAD, if finalised, would be of limited use since the fact pattern is not representative of the diversity and complexity of fact patterns commonly seen in practice. Since the terms 'demand deposits' and 'restrictions' are not defined in IFRS Standards, practice diverges for the classification of deposits in other fact patterns similar to, but not the same, as the one described in the TAD. As outlined in our comment letter on the Request for Information *Third Agenda Consultation*, we believe the International Accounting Standards Board (the Board) should undertake a comprehensive review of IAS 7, focussing on the classification criteria for cash, cash equivalents and restricted cash, amongst other areas highlighted.

For these reasons, we recommend that the Committee does not finalise the TAD, but instead refers the issues identified to the Board as part of a comprehensive review of IAS 7. We believe piecemeal, narrow-scope clarifications will not be effective.

Our key concerns are as follows.

Ambiguity within current IFRS Standards

Since 'demand deposits' and 'restrictions' are not defined in IFRS Standards, practice varies in classification of amounts placed by an entity in a separate account it controls to meet third party commitments. Without a clear definition of these terms, the analysis in the first paragraph of the TAD is circular – saying essentially that a demand deposit with restrictions remains a demand deposit unless the restrictions change its nature such that it is no longer a demand deposit. In the absence of a definition of a demand deposit and further guidance on the types of restrictions that may change the nature of the deposit, this statement is not helpful.

We believe this requires clarification by way of examples or further guidance on what are the restrictions on use that could change the nature of the asset.

While 'restrictions' are not defined in IAS 7, IFRS 12.13 refers to restrictions (e.g. statutory, contractual and regulatory restrictions) on the entity's ability **to access or use** the assets. Paragraph 26 of the staff paper seems to imply that while assessing whether a demand deposit is cash or a cash equivalent, an entity considers restrictions **on access** to the deposit - i.e. restrictions in the terms and conditions of the deposit but **not restrictions on the use** of the deposit - i.e. contractual restrictions imposed by third parties. It is not clear as to the basis in IAS 7 for distinguishing types of restrictions in this manner.

Given that fact patterns related to deposits vary significantly in practice, a clear explanation of how the restrictions are to be analysed is very important. The TAD itself may not eliminate existing ambiguity and divergent interpretations may continue for similar or more common fact patterns.

We note that the Board considered addressing 'restrictions' in its Exposure Draft 2015-06 *Disclosure Initiative - Proposed Amendments to IAS 7*; however, the Board did not confirm these specific proposals in the final amendments to IAS 7 since it believed that further work was needed. We believe the Board is best suited to consider this matter further, rather than the Committee.

> *BC 25 To supplement the current disclosure requirements in paragraph 48 of IAS 7 the 2014 Exposure Draft proposed additional disclosure requirements about an entity's liquidity such as restrictions that affect an entity's decision to use cash and cash equivalent balances.* ***However, in the light of the responses, the Board decided that further work is needed before it can determine whether and how to finalise requirements arising from that proposal.*** *The Board decided to continue that work without delaying the improvements to financial reporting that it expects will result from adding paragraphs 44A–44E to IAS 7. The Board may also, in due course, consider adding to its technical work programme a project that would look at liquidity disclosures more broadly. [Emphasis added]*

Usefulness of classification outcomes under IAS 7

If the TAD is finalised as drafted, we question whether current IFRS requirements provide decision-useful information to users of the financial statements – i.e. is it helpful to present an amount as 'cash' even when its use is restricted so that it is not available to meet short-term cash commitments? Current IAS 7 requires the 'purpose test' only for cash equivalents. In a slightly amended fact pattern, it appears that the deposited amount would not be classified as cash and cash equivalents, despite the arrangement being economically similar. Consider the following example.

The fact pattern is identical to that described in the TAD except that the entity decides to deposit the amount into a 7-day deposit account (that is, were the entity to request any amount from the deposit, it would receive that amount after 7 days). Following the logic in the TAD, since the amount is not accessible on demand, it is not a demand deposit and is therefore not 'cash'. The deposit would be subject to the 'purpose test' under IAS 7.7 and arguably would not be classified as a 'cash equivalent' either given the purpose test would not be met.

When the overall objective of IAS 7 is considered, it is questionable whether users are getting appropriate information if amounts that cannot be used to meet short-term cash commitments because of third-party restrictions are classified as 'cash' as long as the amounts are accessible on demand from the deposit-taker.

Clarity of the TAD and its scope

It is not clear how broadly the conclusion in the specific fact pattern should be applied, specifically whether the sequence of events matters or not. In some common fact patterns, restrictions on cash deposits stem from a contractual arrangement that involves a transfer of cash between two counterparties, for example, a lease contract: the lessee is required to pay a maintenance deposit to the lessor, which the lessor may then, upon receipt, deposit with a financial institution under terms at its discretion.

Some read the TAD in a way that the sequence of events matters, specifically where the demand deposit comes first and the third-party restrictions on use come second. That is:

1) The entity has a demand deposit.
2) It then enters into a contractual arrangement with the third party which does not change the terms of the demand deposit but introduces additional contractual obligations on use.
3) The conclusion in the TAD is that the subsequent contractual restrictions do not result in the deposit no longer being cash, unless the restrictions change the nature of the original deposit.

However, others read the TAD more widely to apply to **any** fact pattern where a deposit is accessible on demand from the deposit-taker while also being subject to third-party restrictions that stem from a pre-existing or concurrent contractual arrangement. In the lease example above, if the TAD is assumed to apply irrespective of the sequence of events, then the amount deposited by the lessor would be considered 'cash' despite the pre-existing contractual restrictions on its use. This may affect how such deposits are classified currently in practice.

We are concerned that this lack of clarity will create more diversity in practice rather than reduce it.

Disclosures under IAS 7.48

Lastly, we note that the reference to IAS 7.48 may not be appropriate for providing the requisite disclosures in the fact pattern presented in the TAD as this paragraph discusses "significant cash and cash equivalent balances held by the entity **that are not available for use by the group"** [Emphasis added]. This is not necessarily the case in the fact pattern described in the TAD.

In summary, in light of the concerns outlined above we recommend that the Committee does not finalise the TAD but instead refers the issues identified to the Board. We believe the Board should undertake a comprehensive review of IAS 7.

Please contact Reinhard Dotzlaw at reinhard.dotzlaw@kpmgifrg.com or Gabriela Kegalj at gabrielakegalj@kpmg.ca if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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