TARGET VERSUS TESCO: COMPARING THE REPORTING OF CASH FLOWS UNDER GAAP AND IFRS

Kennard S. Brackney, Ph.D., CPA
Harlan E. Boyles Professor

Tracy N. Reed, Ph.D., CPA
Assistant Professor

Department of Accounting
Walker College of Business
Appalachian State University
Boone, NC 28608

brackneyks@appstate.edu
(828) 262-6210

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INTRODUCTION

Convergence of U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) has been a high-profile issue for several years. However, in a report released by the Securities and Exchange Commission (SEC) in 2012, the SEC appears to back away from adoption of IFRS, citing significant remaining differences between the two sets of standards as a part of the reason for the shift away from adoption (SEC 2012). The two standard-setting bodies, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), are working to converge on a few more of these differences, but a sizeable number will remain. One example of a remaining difference is the reporting of cash flows. GAAP and IFRS provide guidance that is conceptually similar, but can differ significantly on detailed requirements and implementation.

This paper offers a statement of cash flows assignment that faculty can use to help accounting students develop a better understanding of an often-overlooked financial statement as well as some of the significant differences between the GAAP and IFRS guidance. The assignment requires students to compare the reporting of cash flow information by two large retailing companies from different countries, Target Corporation and Tesco PLC, to gain insight into how the GAAP and IFRS guidance differs. Students must review the statements of cash flows and related note disclosures for the companies and research the relevant GAAP and IFRS standards that drive many of the differences in their reporting of cash flow information. This assignment can be used in an intermediate accounting course that covers the statement of cash flows or a separate international accounting course that includes a unit on IFRS.

LEARNING OUTCOMES

This assignment aims to give students:

(1) a better sense of the purpose and structure of the statement of cash flows;
(2) a stronger working knowledge of the applicable GAAP and IFRS standards, and the differences between them; and
(3) additional experience reading and interpreting the GAAP and IFRS standards.

CASH FLOW REPORTING STANDARDS

<u>Background</u>

The guidance in GAAP is based largely upon a standard issued by the FASB in 1987, Statement of Financial Accounting Standards (SFAS) No. 95, *Statement of Cash Flows*. SFAS 95, for the first time, required that all business entities present a statement of cash flows. It replaced a standard the Accounting Principles Board issued in 1971, Opinion (APBO) No. 19, *Reporting Changes in Financial Position*. APBO 19 called for companies to present a statement of changes in financial position, also known as a funds flow statement. The standard gave companies flexibility in defining “funds,” but required that they report the net change in working capital or cash from their operations (¶10).

Spiller and Virgil (1974, p. 115) observed that, for the first year APBO 19 was effective, 131 of 143 sample companies, 92%, defined funds as working capital. A decade later, when the FASB was developing SFAS 95, it noted an emerging trend in practice to define funds as cash (¶9). In the final standard, the FASB defined funds as cash and cash equivalents, and it required that cash flows be reported separately for operating, investing and financing activities. The Board approved the standard by a narrow 4-3 vote. The dissenting votes disagreed with several aspects, including the prescribed classification of interest received, dividends received and interest paid as operating cash flows. The current GAAP guidance is found in Accounting Standards Codification (ASC) section 230 – Statement of Cash Flows.

The current guidance in IFRS comes from a standard the International Accounting Standards Committee issued in 1992, International Accounting Standard (IAS) 7, *Cash Flow Statements*. In many ways, IAS 7 was modeled after SFAS 95. It required all business entities applying IFRS to present a statement of cash flows. The 1992 pronouncement replaced an earlier version of IAS 7, titled *Statement of Changes in Financial Position*. The earlier (1977) version required a funds flow statement. In 2007, the IASB approved revisions to IAS 1, *Presentation of Financial Statements* that, among other things, changed the title of IAS 7 to *Statement of Cash Flows*. A BDO guide on IAS 7 (2014, p. 3) describes the standard as more succinct and more stable than most others in IFRS. IAS 7 includes just 58 paragraphs, and it has changed relatively little since 1992.

Similarities and Differences

The GAAP and IFRS standards on reporting cash flows are similar in their basic approach. Both require presenting a statement of cash flows as a primary financial statement. Both require companies to explain changes in cash and cash equivalents and classify the changes according to the categories operating, investing and financing. For the operating classification, both state a preference for the direct method, but permit companies to use the indirect method. Both require disclosures, such as significant noncash investing and/or financing activities.

The two standards are similar enough in their basic approach that, previously, the SEC viewed a cash flow statement and related disclosures prepared based on IAS 7 as an acceptable substitute for the information GAAP requires. Prior to 2007, the SEC required foreign registrants using IFRS to supply a U.S. GAAP reconciliation, the equivalent of a set of U.S. GAAP financial statements. The SEC exempted a few items, such as cash flows reported according to IAS 7 (SEC 2000). The importance of this special exemption has diminished as the SEC now accepts the full set of financial statements prepared according to IFRS as, in substance, the equivalent of U.S. GAAP financial statements for foreign registrants.

While the standards are similar in their basic approach, they differ on a number of their technical requirements. Based upon our review and comparison of the two standards, we identified approximately 25 differences in the technical requirements. To gain insight into the nature of these differences, we categorized them as follows:

(1) Cash equivalents – a difference in the operational definition of cash equivalents for purposes of the statement of cash flows.
(2) Classification – a difference in how a cash flow item is classified: operating, investing or financing.
(3) Presentation – a difference in *whether*, and to a lesser degree, *how* a cash flow item is presented in the statement of cash flows.
(4) Measurement – a difference in how a reported cash flow item is measured.
(5) Disclosure – a difference in *whether*, and to a lesser degree, *where* (in the statement or in the notes) additional information is reported.

The category accounting for the largest number of differences is Presentation, followed by Classification, followed by Disclosure. Together, these three categories accounted for close to 90% of the differences we identified.

In comparing the standards, in some cases, both have established a requirement, and the requirements differ (6 cases). Examples include the treatment of bank overdrafts, the presentation of interest paid and income taxes paid, and the disclosure of noncash investing and/or financing activities. For the majority of differences, though, only one of the standards has established a single mandated treatment (19 cases). The cases are split nearly evenly between GAAP (10) and IFRS (9). The cases where GAAP mandates a specific treatment, but IFRS does not, relate primarily to *classification* issues (6 of the 10). Examples include the classification of interest received, dividends received, interest paid, capitalized interest paid, dividends paid and income taxes paid. In contrast, the cases where IFRS mandates a specific treatment, but GAAP does not, relate mainly to *presentation* issues (6 of the 9). Examples include the presentation of interest received, dividends received, dividends paid and principal paid on capital leases.

GAAP tends to be more prescriptive in the classification of cash flows, while IFRS tends to be more prescriptive in the presentation of cash flows. The two standards also differ somewhat on their guidance for the disclosure of additional information.

FASB-IASB Convergence

The FASB and IASB have been working to converge their standards for more than a decade. The pace of convergence accelerated with the Boards' release of a detailed project agenda in 2006. Although the Boards did not include the statement of cash flows as a distinct project, they did intend to address the reporting of cash flows through the Financial Statement Presentation joint project.

In 2008, the Boards released a joint discussion paper, *Preliminary Views on Financial Statement Presentation*. The discussion paper proposed several changes pertaining to the reporting of cash flow information, including:

- dropping the concept of cash equivalents;
- using just two classifications: business, which would include operating and investing as subcategories, and financing;

- ○ tying the classification of an item in the statement of cash flows to the classification of the related asset or liability in the balance sheet;
- ○ requiring the direct method for operating activities; and
- ○ requiring a reconciliation of comprehensive income to net cash flow.

In July 2010, the Boards posted for public comment a joint draft of an exposure draft, *Staff Draft of an Exposure Draft on Financial Statement Presentation* (FASB 2010b). The staff draft retained most of the changes proposed in the discussion paper, and it introduced new changes to the classification of cash flows that would permit more flexibility for U.S. companies. The staff draft proposed allowing companies to classify interest and dividends received as investing cash flows (¶¶81-82) and interest paid as a financing cash flow (¶¶85-87).

The Boards were proposing even more dramatic changes for the other financial statements. Stakeholders expressed concerns about many of them, and in October 2010, the Boards decided to set the Financial Statement Presentation project aside to focus instead on a small set of priority projects (FASB 2010a). With the bilateral convergence initiative winding down, it seems unlikely the Boards will make any further progress with this project. The IASB prefers a multilateral approach, and in 2013, it formed the Accounting Standards Advisory Forum to solicit input and assistance from a wider range of standard setters. Apart from a new, narrow-scope FASB project to clarify the classification of a select few items (Clarifying Certain Existing Principles on Statement of Cash Flows), neither Board is pursuing a general convergence of the existing differences in reporting of cash flow information. Thus, it appears the existing set of differences will continue for the foreseeable future.

CASE COMPANIES

This assignment asks students to compare the reporting of cash flow information by two listed companies, one using GAAP and the other IFRS. We chose two large retailers, Target and Tesco, for students to compare. Below, we provide a brief profile of each company.

Target Corporation

Target is headquartered in the U.S. It operates mainly in the Department Stores industry (NAICS code = 452111). According to a Deloitte (2014) study, *Global Powers of Retailing 2014*, based on sales for 2012, Target is the world's 10th largest retailer. For the year ended February 2, 2013, Target generated retail revenue of $72 billion. It conducts activities in just two countries, the U.S. and Canada. In the most recent fiscal year, ending February 1, 2014 (fiscal 2013), the U.S. accounted for 98% of the company's revenue (Annual Report Note 28). The grocery business is a significant part of the company, accounting for 21% of the U.S. revenue (Annual Report Note 29). Target's shares are listed on the New York Stock Exchange, and it uses GAAP for financial reporting purposes.

Tesco PLC

Tesco is headquartered in the United Kingdom (U.K.), and it operates mainly in the Supermarkets and Other Grocery Stores industry (NAICS code = 445110). According to the

Deloitte study, based on 2012 sales, Tesco is the world's 2nd largest retailer. For the year ended February 23, 2013, Tesco generated retail revenue of $101 billion. Tesco operates in Europe and Asia, a total of 11 countries. For the year ended February 22, 2014 (fiscal 2013), the U.K. accounted for 68% of the company's revenue (Annual Report Note 2). Tesco's business lines include groceries, clothing, general merchandise and services such as banking (Annual Report p. 11). The company's Tesco Extra format accounts for the largest percentage of floor space in U.K. operations, 42% (Annual Report p. 139). Through this format, it sells groceries, clothing, electronics and entertainment (Wikipedia). Tesco's shares are listed on the London Stock Exchange, and it uses IFRS for financial reporting purposes.

Tesco made headlines recently for its accounting practices. On September 22, 2014, the company announced the discovery of accounting irregularities, and it lowered a previous forecast of profits for the first half of 2014 by £250 million (Tesco 2014b). On October 23, Tesco reported the overstatement of profits amounted to £263 million, and more than half related to prior years, including 2013. Tesco admitted to recognizing revenues for rebates from suppliers too quickly and related expenses too slowly. Retailers such as Tesco can earn rebates from their suppliers for promoting their products to customers. Tesco's mishandling of these items caused its profit before tax for 2013 to be overstated by £70 million. The company does not view this amount as material, so it is not planning to restate the 2013 financial statements (Tesco 2014a). For purposes of this assignment, a few line items could be slightly misstated, but the classification of items and the company's overall presentation of cash flows should not be affected.

Target and Tesco overlap some in their business activities, so they should experience and report similar types of business transactions. And despite Tesco's revelation of accounting problems, the two companies offer a good contrast of the GAAP and IFRS requirements for the reporting of cash flows.

CASE REQUIREMENTS

Tasks

Review the fiscal year 2013 statement of cash flows and related disclosures for each company. Recalling the five categories of differences discussed in the Cash Flow Reporting Standards section above, search for differences in reporting that arise from differences in the guidance provided on reporting of cash flow information in the two standards. Identify at least eight differences, and supply the following information for each one:

- state the issue;
- briefly describe Target's treatment under GAAP;
- give the citation in the Codification that requires, or permits, this treatment;
- briefly describe Tesco's treatment under IFRS; and
- give the citation in IFRS (standard and paragraph number) that requires, or permits, this treatment.

Present your findings in a table. Use the template provided in Exhibit 1 as a guide for formatting your table.

Resources

You can access the fiscal year 2013 financial statements for each company from the Investors section of each company's website. For Target (www.target.com), follow the links to download the company's 2013 Annual Report (10-K), for the year ended February 1, 2014. See the comparative statements of cash flows and the related information reported in Notes 9, 15, 18 and 20. For Tesco (www.tescoplc.com), follow the links to download what the company calls its Annual Report 2014, for the year ended February 22, 2014. See the comparative cash flow statements and the related notes (1, 5, 7, 11, 18, 20 29, 30 and 34) and supplemental information (pages 132-142).

As far as the standards, you can access the Codification from the FASB's website (www.fasb.org). Anyone can register to access the Basic View free of charge. Through your institution, you may find you have access to the Academic View. This assignment can be completed using either view. You can access IFRS free of charge from the IFRS Foundation's website (www.ifrs.org). As with the Codification, you must register to establish an account.

You may find it helpful to consult other sources that discuss IFRS and the significant differences with GAAP. Examples include intermediate accounting and international accounting textbooks and reports prepared by many of the larger public accounting firms. A few of the reports prepared by public accounting firms that you may find particularly useful for purposes of this assignment include:

- Grant Thornton's *Comparison of U.S. GAAP and International Financial Reporting Standards* (April 2014);
- KPMG's *IFRS compared to US GAAP: An overview* (November 2013); and
- PwC's *IFRS and US GAAP: similarities and differences* (October 2014).

Further Suggestions

Bear in mind that Target and Tesco are different companies, with distinct business models. Concentrate on differences in their reporting of cash flow information that reflect differences in the guidance on reporting this information in GAAP and IFRS. It is quite possible that one of the companies will present a line item in the statement that the other does not present. The question to ask is, does the reporting difference arise from a requirement, allowance or suggestion stated in one standard, but not the other.

We have identified approximately 15 differences. You should not have much trouble locating the minimum requirement of eight, particularly if you keep in mind the five categories of differences discussed above. You may use an item of information more than once. For example, a given item of information could reflect both a difference in classification and a difference in presentation.

Finally, note that for a few of the differences, the citations are outside of ASC 230 and IAS 7. For one of the differences, the citation from the Codification for the GAAP treatment comes from section 205 – Presentation of Financial Statements. Other standards cited from IFRS include IAS 1, *Presentation of Financial Statements*, and IFRS 5, *Noncurrent Assets Held for Sale and Discontinued Operations*.

IMPLEMENTATION

The authors used this assignment in separate sections of an international accounting course they taught in Spring 2014. The course covers a variety of international accounting topics, including GAAP and IFRS differences. The two sections were taught in compressed timeframes of seven weeks and four weeks to accommodate the scheduling needs of returning interns. A total of 75 students completed the assignment as a required, outside-of-class activity. Students worked in pairs, and the assignment was worth approximately 5% of the course grade.

Based upon our observations to date, students performed as well on this assignment as others given during the term. The most challenging aspect for them appears to be understanding that a particular information item could represent more than one difference. For example, a single information item could reflect both a difference in classification (i.e., operating, investing or financing) and a difference in presentation (i.e., whether or how the item is shown in the body of the statement). In response to this observation, we have given more emphasis to the potential for an information item to be used multiple times in the present version of this assignment.

While we used this assignment in an international accounting course, it could certainly be used in an intermediate accounting course that covers the statement of cash flows topic, especially if the instructor is trying to incorporate IFRS. Another feature of this assignment is that it can be modified fairly easily to work for a different reporting year (e.g., fiscal year 2014 when available) or for different pairs of companies. We chose Target and Tesco because they engage in familiar retailing operations, and they offer an interesting set of differences in their reporting of cash flow information. This assignment can easily be adapted to compare a different pair of companies as long as one uses GAAP and the other uses IFRS.

We solicited feedback from students by asking them to complete a short, five-question evaluation. Of the 75 students who completed the assignment, 65 also completed the questionnaire. Using a five-point Likert scale, where 1 = Strongly Agree, 2 = Agree, 3 = Neutral, 4 = Disagree, and 5 = Strongly Disagree, students indicated strong agreement the assignment increased their knowledge of GAAP versus IFRS (mean = 1.692) and that it was a challenge for them (mean = 1.685). They also indicated strong agreement the assignment should be completed in groups (mean = 1.692). The students indicated marginal agreement on their enjoyment of the assignment (mean = 2.677), but agreement that it should be used in future offerings of the course (mean = 2.154). Exhibit 2 presents the means and standard deviations for student responses.

In their open-ended comments, students said they enjoyed working with a financial statement that is not covered extensively in other undergraduate courses; they liked the fact that the assignment uses real world companies rather than fictitious ones; and that even though they found the assignment challenging, it helped them to better understand the differences between the two standards. They also stated that more-detailed instructions would be helpful, as well as more leeway in the grading. Overall, the students seemed to see value in this assignment.

Finally, note that Tesco's recent admission of accounting problems likely impacts the amounts for a few of the line items in the 2013 statement of cash flows. In Note 2 to the 2014 first half financial statements (Commercial income recognized in previous periods), Tesco assessed the overstatements of profit before tax in prior years, totaling £145 million, as not material. It simply charged the corrections against the 2014 first half profit, as permitted by IAS 8, *Accounting Policies, Changes in Estimates and Errors* (¶IN7). Tesco does not plan to restate the prior years (Tesco 2014a). As a result, a few of the line items in Note 29 to the 2013 financial statements (Reconciliation of profit before tax to cash generated from operations) probably are slightly misstated. The line item Profit before tax likely is slightly overstated and the line item Increase / (decrease) in trade and other payables may be slightly understated, quite possibly by offsetting amounts. Apart from these minor misstatements, the presentation of cash flow information should not be affected.

The UK's market regulator, the Financial Conduct Authority, is investigating Tesco's accounting practices. If the regulator uncovers more problems affecting 2013, it is conceivable Tesco would need to restate its financial statements for that year. We encourage faculty using this assignment to check the Tesco website to make sure they have the most recent version of the company's 2013 financial statements.

CONCLUSION

Among the primary financial statements, the statement of cash flows does not always receive the attention in the accounting curriculum it deserves. This paper offers an assignment that gives students opportunity to focus on the statement of cash flows and compare how the reporting of cash flow information by two listed companies may differ based on reporting standard. We selected two companies to highlight the surprisingly large number of differences between GAAP and IFRS standards related to the statement of cash flows. Through completing this assignment, students should gain a better understanding of both the statement of cash flows and the significant differences between the applicable GAAP and IFRS standards.

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EXHIBIT 1: TEMPLATE FOR GAAP/IFRS DIFFERENCES AND LITERATURE CITATIONS

Issue	Target's Treatment under GAAP	Tesco's Treatment under IFRS
Issue 1 . . .		
Issue 2 . . .		
Issue 3 . . .		
Issue 4 . . .		
Issue 5 . . .		
Issue 6 . . .		
Issue 7 . . .		
Issue 8 . . .		

EXHIBIT 2: STUDENT QUESTIONNAIRE RESULTS

Question	Mean (Std. Dev.)*
I enjoyed completing the Cash Flow Comparison case.	2.677 (0.896)
I would recommend that my instructor use the Cash Flow Comparison case again in future sections of this class.	2.154 (0.769)
I would recommend the Cash Flow Comparison case be completed in groups.	1.692 (0.876)
I found completing the Cash Flow Comparison case to be a challenging exercise.	1.685 (0.699)
Completing the Cash Flow Comparison case increased my knowledge of U.S. GAAP vs IFRS.	1.692 (0.606)

*Used Likert scale where 1=Strongly Agree, 2=Agree, 3=Neutral, 4=Disagree, and 5=Strongly Disagree

SUGGESTED SOLUTION: GAAP/IFRS DIFFERENCES AND LITERATURE CITATIONS

Issue	Target's Treatment under GAAP	Tesco's Treatment under IFRS
(1) Classification – interest received	Target does not indicate the classification of interest received. GAAP requires this item be classified as operating, so it is reasonable to believe Target included interest received in the Cash flow provided by operations (ASC 230-10-45-16b).	Tesco classifies interest received as investing, as permitted by IFRS. IFRS grants companies a policy choice: operating or investing (IAS 7 ¶33).
(2) Classification – dividends received	Target does not indicate the classification of dividends received. GAAP requires this item be classified as operating, so it is reasonable to believe Target included dividends received in the Cash flow provided by operations (ASC 230-10-45-16b).	Tesco classifies dividends received as investing, as permitted by IFRS. IFRS grants companies a policy choice: operating or investing (IAS 7 ¶33).
(3) Presentation – starting income figure for indirect format	Target uses the indirect format to present operating cash flows, and it starts with *Net earnings*. GAAP requires this format to begin with net income (ASC 230-10-45-28).	Tesco uses the indirect format as well, and it begins with *Profit before tax*. IFRS requires companies to begin with profit or loss, but does not specify a particular measure of profit or loss (IAS 7 ¶20).
(4) Presentation – interest received	Target does not present the interest received. GAAP requires companies using the direct method to present this item in the operating section (ASC 230-10-45-25b). There is no requirement for companies using the indirect method, as Target does, to present this item.	Tesco presents interest received as a separate line item in the body of the statement, as required by IFRS (IAS 7 ¶31). For the classification, see Issue 1 above.
(5) Presentation – dividends received	Target does not present the dividends received. GAAP requires companies using the direct method to present this item in the operating section (ASC 230-10-45-25b). There is no requirement for companies using the indirect method, as Target does, to present this item.	Tesco presents dividends received as a separate line item in the body of the statement, as required by IFRS (IAS 7 ¶31). For the classification, see Issue 2 above.
(6) Presentation – interest paid	Target presents interest paid in a supplemental information section of the statement. For companies using the indirect method, like Target, GAAP requires disclosure of this item in the body or notes (ASC 230-10-50-2).	Tesco presents interest paid as a separate line item in the body of the statement, as required by IFRS (IAS 7 ¶¶31-32). Tesco classifies this item as operating.

(7) Presentation – income tax paid	Target presents income tax paid in the supplemental information section of the statement. For companies using the indirect method, like Target, GAAP requires disclosure of this item in the body or notes (ASC 230-10-50-2).	Tesco presents income tax paid as a separate line item in the body of the statement, as required by IFRS (IAS 7 ¶35). Tesco classifies this item as operating.
(8) Presentation – principal payments on capital/finance leases	Target does not report the repayment of capital lease principal separately from repayment of loan principal in general. Target includes capital lease obligations in the balance sheet item *Long-term debt and other borrowings* (see Note 18). In Note 20, Target reports minimum lease payments on capital leases due in the next year (2014), but does not state the amount of principal repaid in the current year (2013). GAAP does not require separate disclosure of this item (see ASC 230-10-45-15).	Tesco presents the principal repaid on finance leases as a line item in the financing section, separate from other repayments of loan principal. IAS 7 makes specific mention of payment of a finance lease liability in a list of examples of financing cash flows (¶17e). ¶21 requires separate reporting of major classes of investing and financing cash flows, though the focus appears to be more on gross rather than net reporting of them. No further examples subject to gross reporting are provided. At a minimum, IAS 7 encourages separate reporting of this item.
(9) Presentation – number of comparative years	Target presents two comparative years (2012 and 2011) to satisfy an SEC requirement. GAAP encourages, but does not require, presentation of comparative years (ASC 205-10-45-2).	Tesco presents one comparative year (2012), as required by IFRS (IAS 1 ¶38A).
(10) Presentation – cross-referencing from statement to notes	Target makes a general reference to see the accompanying notes. GAAP does not require references to specific notes, and Target does not provide this information.	For five different line items presented in the body of the statement, Tesco refers to specific notes (7, 8, 18, 27 and 29). IFRS requires specific references to the notes in all primary financial statements (IAS 1 ¶113).
(11) Measurement – interest paid	GAAP requires the interest paid figure presented exclude any capitalized interest (ASC 230-10-50-2). Target reports the item *Construction in progress* in its February 1, 2014 balance sheet, so it likely did capitalize some interest during the year. If Target complied with GAAP, it is reasonable to believe the interest paid figure the company reports *excludes* the capitalized interest.	IFRS requires the interest paid figure presented include any capitalized interest (IAS 7 ¶32). Tesco states it capitalized £79 million of interest in 2013 (see Notes 5 and 11). If Tesco complied with IFRS, it is reasonable to believe the interest paid figure the company reports *includes* the capitalized interest.
(12) Disclosure – noncash financing and/or investing activities	Target presents a section, *Noncash financing activities*, in the statement itself. GAAP permits companies to disclose these activities in the statement or the notes (ASC 230-10-50-6).	Tesco does not provide any information on these activities. IFRS requires companies to report on their noncash activities, but the standards expressly prohibit them from showing this information in the statement itself (IAS 7 ¶¶43-44).

(13) Disclosure – cash flows from discontinued operations	Target did not report any discontinued operations during the period 2011 to 2013. GAAP permits, but does not require, companies to present information on cash flows from discontinued operations (ASC 230-10-45-24).	Tesco reports discontinued operations stemming from 2013 disposals of U.S. and China operations. Tesco shows cash flows from discontinued operations, classified according to operating, investing and financing activities (see Note 7). IFRS requires companies to provide this information (IFRS 5 ¶33c). Additionally, Tesco shows the full operating section for discontinued operations as supplemental information (see page 135).
(14) Disclosure – components of cash and cash equivalents	Target provides some information on cash equivalents, but does not give a full accounting for the total cash and cash equivalents of $695M. Target mentions two components of cash equivalents that sum to $350M (see Note 9). GAAP requires disclosure of the policy followed for defining cash equivalents, but does not require an accounting for the total of cash and cash equivalents (ASC 230-10-50-1).	Tesco shows the components of cash and cash equivalents (see Note 18). IFRS requires companies to disclose both the policy for defining cash equivalents and the composition of total cash and cash equivalents (IAS 7 ¶¶45-46).
(15) Disclosure – segmental cash flows	Target reports two segments (see Note 28). GAAP does not address the disclosure of cash flows by segment, and Target does not supply this information.	Tesco reports four segments (Note 2). IFRS encourages companies to disclose cash flows for reportable segments (IAS 7 ¶¶50&52). Tesco provides complete cash flow statements for its two business lines (Retail and Tesco Bank) as supplemental information (see page 134).

SUGGESTED SOLUTION: COMMENTS ON IDENTIFIED DIFFERENCES

Issues 1 and 2

IAS 7 gives companies some discretion in the classification of cash flows (¶11). The standard allows companies to classify cash flows such as interest received and dividends received in the manner that best reflects the activities of the business. Given the way Tesco classified these cash flows, it must view them as part of its investing activities.

Issue 3

Target and Tesco both elect to use the indirect method for presenting their operating activities sections. GAAP requires companies to begin the reconciliation of income to net operating cash flow with the net income figure. IAS 7 states companies must begin with profit or loss (¶20). Appendix A of the standard shows an example of the indirect method, and the example begins the operating section with profit before tax. It is common for companies using IFRS to start with profit before tax as doing so simplifies the presentation of income taxes. IAS 7 requires companies to present the income tax paid amount in the body (three main sections) of the statement, and the item normally should be classified as operating (¶35). If a company started with net income instead, it would need to add back income tax expense and then subtract the income tax paid.

Target begins its operating section with *Net earnings*, the net income reported in the Statements of Operations. Tesco starts its operating section with *Profit before tax* (Note 29), and it shows a subtraction for *Corporation tax paid* in the body of the statement.

Issues 4 and 5

For the items interest received and dividends received, the GAAP and IFRS guidance differs in two ways. First, the standards differ on how these items should be classified in the statement of cash flows (see Issues 1 and 2). Second, the standards also differ on whether each item must be presented as a separate line in the body of the statement. IFRS requires separate presentation of these items, but GAAP does not. Under GAAP, companies electing the indirect method, as Target does, are not required to present these items. The reporting by Target and Tesco illustrates both of these differences.

Issues 6 and 7

IFRS gives companies a policy choice to classify interest paid as operating or financing (IAS 7 ¶33). Tesco elected to classify interest paid the same as GAAP mandates, operating. With regard to income tax paid, the two standards generally require this item be classified as operating (ASC 230-10-45-17c and IAS 7 ¶35). Tesco classified both of these cash flow items as operating, and given the guidance in GAAP, Target probably did as well. There is one notable difference in their reporting of these items, though, and it relates to presentation. U.S. companies electing the indirect method, like Target, must report both items, but may do so through disclosure in the notes. In contrast, IFRS requires companies to present these items in the body of the statement.

Issue 11

GAAP requires the reported interest paid be measured excluding capitalized interest, while IFRS requires this item be measured including capitalized interest. Both companies appear to have capitalized some interest during the year. Consistent with GAAP, Target labels its interest paid item as being net of capitalized interest. Tesco reports interest paid of £496 million, but does not give any further information on this item.

The precise nature of the difference in reporting for interest paid depends upon the classification and presentation requirements for *capitalized* interest paid. GAAP requires that capitalized interest paid be classified as investing, but the amount need not be separately presented. IFRS does not provide any guidance on the classification of this item. The amount must be included in the interest paid presented in the body of the statement, but there is no requirement for the capitalized amount to be separately presented.

In a 2012 exposure draft, *Annual Improvements to IFRSs 2010-2012 Cycle*, the IASB proposed that capitalized interest paid be classified as investing in the statement of cash flows (see pages 35-38). The IASB subsequently tabled this matter, so companies using IFRS continue to have flexibility in classifying capitalized interest paid. The options appear to be the general ones of operating and financing, plus investing.

It is possible Tesco classified the capitalized interest paid in 2013 the same as Target, meaning an investing cash flow. Doing so would have violated IAS 7, though, as the standard requires companies to present an interest paid figure that includes any capitalized interest (¶32). Tesco does not show a separate capitalized interest paid item in its investing section. Also possible, Tesco may have complied with IAS 7 by presenting the total interest paid, and then classified the full amount, including capitalized interest, as operating. If Tesco used the second approach, it would have classified the capitalized interest differently than Target did.

Based mainly upon the clear difference in the standards on this point, we believe we can safely say there is a difference in the measurement of the interest paid item. There may be a difference in the classification of the *capitalized* interest paid as well, but Tesco does not provide enough information to determine this. Thus, we categorize the observed difference as relating to measurement.

Issue 12

As permitted by GAAP, Target reports its noncash investing and/or financing activities as supplemental information in the statement of cash flows. Target discloses one item, assets and liabilities arising from new capital leases. In contrast, Tesco does not provide any information on noncash investing and/or financing activities. It would be required to disclose these activities, if it had them. IAS 7 ¶44a specifically mentions entering into a finance lease as an example of such activities. Tesco reports finance leases, but it shows a decrease in both the assets (from £157 million to £151 million) and the liabilities (from £128 million to £121 million) during the year (see Notes 11 and 34). From this information, it appears Tesco may not have entered into any new finance leases in fiscal year 2013.

The disclosure of noncash investing and/or financing activities qualifies as a difference because the reporting Target gives would not be permitted under IFRS. IAS 7 requires that noncash investing and/or financing activities be excluded from the statement, but disclosed in the notes (¶¶43-44).

Issue 13

As shown in the table, Tesco discloses the net effects of discontinued operations on cash flows from operating, investing and financing activities, as required by IFRS 5. The FASB recently issued ASU 2014-08, *Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*, which modifies the definition and required disclosures for a discontinued operation. ASU 2014-08 directs companies reporting a discontinued operation to disclose, among other things, either (1) the net effects on cash flows from operating and investing activities or (2) the net effects on depreciation, amortization, capital expenditures and significant operating and investing noncash items. Listed companies such as Target must begin applying the new standard in fiscal periods beginning after December 15, 2014.

Note that under the new guidance, Target still will not be required to supply the information that Tesco did. Target could move some in that direction, though, by choosing to disclose the net effects on operating and investing cash flows.

Evaluation of Tesco's Reporting

A company applying IFRS could choose to use the discretion IAS 7 permits in classification of cash flows to increase, or decrease, its net cash flow from operating activities. Tesco's classification choices caused its net operating cash flow for 2013 to be shown at a *lower* amount. If Tesco had classified interest received and dividends received as GAAP requires, operating cash flows, its net operating cash flow for 2013 would have increased from £3,185 million to £3,368 million, a 5.7% increase. If Tesco had gone a step further, and classified its interest paid as a financing outflow, the net operating cash flow for 2013 would have increased from £3,368 million to £3,864 million, a total increase of 21.3%. From this analysis, it does not appear Tesco is using its classification choices to make its operating cash flow look better.

Applying IFRS, Tesco provides a clearer picture of the effects of interest and dividend receipts and interest, income tax and finance lease principal payments on its operating, investing and financing activities. Tesco also provides more transparency on the components of cash and cash equivalents, the effects of discontinued operations on cash flows, and the cash flows from its two main business lines. On the other hand, Tesco does not give any information on its classification of *capitalized* interest paid or its noncash investing and/or financing activities.

SUGGESTED SOLUTION: COMMENTS ON OTHER OBSERVED DIFFERENCES

Comparing the companies' reporting of cash flows, there are several other obvious differences in presentation. We did not include these differences in the table because they do not arise from differences in the standards. One example is the location of reporting the adjustments to income under the indirect method. Target presents these adjustments in the body of the statement, specifically, the operating section. Tesco shows 27 of the 29 adjustments to income in Note 29. It carries only the net figure, *Cash generated from operations*, to the operating section of the statement. As required by IAS 7, Tesco does show the interest paid and income tax paid in the body of the statement (operating section). The observed difference in presentation of adjustments to income does not arise from the standards, though, as GAAP too permits them to be shown in the notes (ASC 230-10-45-31).

Another example is Tesco's presentation of a schedule titled *Reconciliation of net cash flow to movement in net debt note* directly below the cash flow statement. This reconciliation shows the change in cash and cash equivalents in relation to the change in net debt financing. It helps users to see if the change in cash is tied to the change in the amount of debt financing. IAS 7 encourages companies to disclose information that may help users understand a company's financial position and liquidity (¶50). The standard does not refer to this reconciliation, but some companies who use IFRS elect to provide it (PwC 2010).