

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG FR TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG FRB or EFRAG FR TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG FRB, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

## Scope of EFRAG's proactive project on the statement of cash flows and related matters

### Issues Paper

#### Objective

- 1 The purpose of this session is for EFRAG FR TEG to decide the scope of EFRAG's proactive research project on the statement of cash flows and related matters to be recommended to EFRAG FRB.

#### Background

- 2 Following the 2021 consultation on EFRAG's research agenda, EFRAG decided in June 2022 to include on its research agenda a project on the statement of cash flows (see EFRAG [feedback statement](#)).
- 3 The reasons stated for adding this project to the EFRAG proactive agenda were that:
  - (a) the project could be useful for the IASB, as the IASB has also decided to include a project on the statement of cash flows and related matters as research pipeline projects following its Request for Information (RfI) on its Third Agenda Consultation; and
  - (b) the project could encompass supply financing arrangements, which was deemed as a suitable EFRAG proactive project.
- 4 EFRAG FR TEG discussed possible scopes of the project at [its May 2023 meeting](#) (a summary of that meeting is included in paragraphs 2 - 8 of the Appendix). During the discussion TEG members considered previous consultation results. In 2015, EFRAG published the paper [The Statement of Cash Flows: Issues for Financial Institutions](#). The related [feedback statement](#) was published in 2016 (The validity of the feedback received was confirmed in a recent discussion with the FIWG). Shortly after, the UK FRC published the staff discussion paper [Improving the Statement of Cash Flows](#). The related [feedback statement](#) was published in 2017.
- 5 EFRAG FR TEG also previously discussed the project when:
  - (a) deciding to include the project on the EFRAG proactive research agenda in May 2022 (see paragraph 1 of the Appendix);
  - (b) discussing the use of the statement of cash flows and current issues with the EFRAG User Panel [in May 2023](#) (see paragraphs 9 - 14 of the Appendix).

- 6 The EFRAG FRB discussed the project when deciding to include the project on EFRAG's research agenda (see paragraph 15 of the Appendix).
- 7 The IASB has not yet allocated staff to the project and made any decisions on the project in addition to the thoughts communicated in its [Feedback Statement](#) on the Third Agenda Consultation (see paragraphs 16 - 18 of the Appendix).

### **Possible manners to scope EFRAG's research project on the statement of cash flows**

- 8 Based on the discussion of EFRAG FR TEG in May 2023, the EFRAG Secretariat could suggest the following three different alternative manners to scope EFRAG's proactive research project on the statement of cash flows:

- (a) **Benchmark disclosures on cash flows.** The purpose of this project would be to find and present good examples of disclosures related to the statement of cash flows. This would include (but not limited to) disclosures on working capital, classification of cash flows and restrictions related to cash. A concern expressed at the May 2023 EFRAG TEG meeting for this scope was that there would currently not exist many good examples of disclosures.
- (b) **How is the statement of cash flows used?** The purpose of this project would be to describe how users use the statement of cash flows (and hence the objective(s) of the statement and what changes the statement should reflect). A representative from the IASB staff has previously explained that the IASB, as part of the IASB project on the statement of cash flows, would also reach out to users to understand their needs. The project might thus result in the IASB and EFRAG performing similar activities.
- (c) **What are the issues?** The purpose of this project would be to:
  - (i) List, and shortly discuss, different alternative objectives/uses of the statement of cash flows. This will include (but not limited to) the objective of the statement of cash flows being used as a 'storage space' for data that can be used to 'correct' other data or be used in combination with other data to calculate various ratios (i.e., the individual line items are more important than the statement of cash flows itself). It will also consider whether the statement should reflect, changes in cash, changes in cash and cash equivalents or changes in working capital or net debt.
  - (ii) List the issues with current requirements/practice. The issues would be categorised/labelled according to which use/object of the statement of cash flows (in (i)) they would be related to.
  - (iii) Discuss whether the IASB could consider the issues by targeted amendments, or a comprehensive review would be necessary to deal with the issues in a satisfactory manner.

This project (particularly the collection of the issues mentioned in (ii)) was considered to be the most useful of a list of possible scopes by a member of the IASB staff previously consulted on the issue (although the other projects could also be useful). A concern was expressed at the May 2023 EFRAG FR TEG meeting, that (i) and (ii) could give the impression that the IASB could deal with the issues related to the statement of cash flows by targeted improvements. In order not to give such an impression, the EFRAG Secretariat has included (iii) as part of this alternative. The project would, however, not result in clear directions on how to solve the issues with the

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statement of cash flows as one EFRAG FR TEG member thought should generally be the aim of an EFRAG proactive research project. The project proposed under (iii) is intended to identify the weaknesses of the existing standard in preparation for the IASB project and to enable the IASB to work directly and efficiently on possible solutions themselves.

**Questions for EFRAG FR TEG**

- 9 Does EFRAG FR TEG, considering previous discussion of EFRAG FR TEG and the EFRAG User Panel, have other proposals for the scope of an EFRAG proactive research project on the statement of cash flows than those listed in paragraph 8 above?
- 10 What should be the scope of EFRAG's proactive research project on the statement of cash flows?

## Appendix – summary of past discussions

### Previous EFRAG FR TEG discussions

*May 2022 EFRAG FR TEG meeting (including the project on EFRAG's research agenda)*

- 1 When discussing the project at the May 2022 EFRAG FR TEG meeting, the comments were made that:
  - (a) the project should also include disclosures (and should accordingly perhaps be renamed 'cash flow reporting');
  - (b) the following topics should be considered:
    - (i) the definition of cash;
    - (ii) redefining classification principles (e.g., for government grants);
    - (iii) dual characteristics transactions (purchase of an asset with deferred payment terms); and
    - (iv) information on transactions that are not included in the statement of cash flows (non-cash transactions).
  - (c) It would be important to coordinate the work with the IASB to ensure that the work could be used by the IASB and to avoid the organisations to duplicate each other's work. This comment was also made when the EFRAG FRB approved including a project on cash flows on EFRAG's research agenda.

*May 2023 EFRAG FR TEG meeting (scope of the project)*

- 2 EFRAG FR TEG members discussed the possible alternatives for the scope of EFRAG's proactive research project on the statement of cash flows.
- 3 In general members recognised that the standard is relatively old, and the terms and language used are inconsistent and it has few disclosure requirements relative to recent standards.
- 4 Several EFRAG FR TEG members supported a project starting from making an inventory of current issues faced with the statement of cash flows. A member was, however, concerned that such a project could give the impression that the issues with IAS 7 *Statement of Cash Flows* could be addressed by targeted improvements instead of the standard being re-written. One member thought that the issues to be considered by EFRAG could include: what should be included in the statement of cash flows (i.e., what is cash and cash equivalents) and which flows should be included (i.e., considering the agent/principal issue).
- 5 A member thought that the most useful would be to have a project on the objective of the statement of cash flows. The project should be based on an understanding of users' needs. The member thought that liquidity risk – to some extent was already addressed in IFRS 7 *Financial Instruments: Disclosures* and under going concern considerations. Another member, however, thought it was clear that the statement of cash flows served many purposes. It showed the sources of funds and the use of funds during a period.
- 6 Two members thought that EFRAG's project should be a targeted project on disclosures. The project should start by identifying benchmarks. This should include how cash is used in alternative performance measures. A third member

added, that, in addition to disclosures, the project should consider what is cash and cash equivalents. Concerns were expressed about the idea of trying to identify benchmarks for disclosures as there would not be many disclosures to benchmark.

- 7 Concern was expressed on a project on aligning the statement of cash flows with the directions for the statement of performance provided in the project on the primary financial statements, as this could make the statement of cash flows less useful. Instead of considering cohesiveness, reconciliations – e.g., between operation cash flows and operating profit – should be considered.
- 8 Other comments included:
  - (a) it could be useful to consider disclosures on working capital (including what working capital would be without arrangements such as factoring);
  - (b) the project should include information on restrictions on cash;
  - (c) a two-phased approach should be considered as it was urgent to introduce some improvements through disclosures on, for example, how cash flows are classified and unusual transactions;
  - (d) it should be considered only to include 'cash' and not 'cash equivalents' in the statement;
  - (e) an industry specific standard should be considered for financial institutions (or banks – as the view was expressed that insurance companies were not special in this regard) to focus less on cash flow reporting (which is polluted by cash flows on behalf of others) and more on liquidity risk. However, the view was also presented that not requiring a statement of cash flows for financial institutions would create many issues;
  - (f) if EFRAG should do a project on the statement of cash flows, it should do a project that could solve some current issues;
  - (g) in addition to the issues identified by the EFRAG Secretariat, there was also:
    - (i) an issue in relation to share-based payments. Analysts used the statement of cash flows to assess investments, but investments made by share-based payments did not appear from the statement; and
    - (ii) issues relating to currency translations;
  - (h) it was noted that it could be an illusion to think that digitalisation would not help when preparing cash flows from operating activities using the direct method; and
  - (i) it would be useful to have better understanding on how the statement of cash flows is used by users.

### **Previous EFRAG FR TEG and User Panel discussions**

*EFRAG FR TEG and User Panel meeting on 10 May 2023 (uses and issues with the statement of cash flows)*

- 9 During the meeting EFRAG User Panel members provided input on what improvements could be made to IAS 7 Statement of Cash Flows by considering:
  - (a) how to improve the usefulness of the statement of cash flows (what should be the purpose of the statement of cash flows);
  - (b) how users (currently) use the statement of cash flows; and

- (c) what issues users encounter with how statements of cash flows are currently prepared/the current requirements.

*Objective of the statement of cash flows*

- 10 The following views were expressed by users:
- (a) there is no primary objective for the statement of cash flows. It shows where an entity got its money from and what it did with the money;
  - (b) the objective is to explain why cash has not changed with the net profit of the period;
  - (c) the objective is to provide information on liquidity (specifically insurance companies);
  - (d) the objective is to depict the 'rhythm' of the operating, investing and financing cash flows; and
  - (e) the objective is to offer a collection of information that can be used by users in their own analyses on e.g., credit worthiness. Several users considered cash flow information an important piece of information.
- 11 A non-user mentioned that, for financial institutions (banks), the objective should be to provide information on liquidity risk (as the statement of financial position may not reflect problems with liquidity). To consider regulatory requirements in this respect could be a useful starting point for a discussion.

*How the statement of cash flows is used*

- 12 The following uses of the statement of cash flows were provided by users:
- (a) to assess management's stewardship – how the management is dealing with the cash the entity is generating (CapEx policies, capital policies, what is financed, impact on statement of financial position, free cash flow generated compared to invested capital);
  - (b) to help reconcile movements in net debt (e.g., what is repayments and what is interest) to calculate cash yield numbers);
  - (c) to help reconcile cash movements;
  - (d) to assess liquidity;
  - (e) to understand working capital dynamics (e.g., how much working capital is absorbed as the entity grows);
  - (f) to compare CapEx with depreciations (to assess whether entities are growing – and for corrections to discounted cash flows projections). It is used to assess what profit is realised (and not e.g., changes in fair values); and
  - (g) it is currently not used much for banks.

*Issues with the statement of cash flows*

- 13 The following issues were mentioned by users:
- (a) while the statement of cash flows is useful for insurance companies, it is not useful for banks;
  - (b) the statement of cash flows is prepared very differently from one entity to another. Comparability is an issue;

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- (c) dividends to non-controlling interests are often included in the same figure as dividends to the entity's shareholders;
  - (d) business combinations complicate the interpretation of the information in the statement of cash flows;
  - (e) it could be more useful to reconcile net debt (net financial obligation or net interest-bearing instruments or something similar);
  - (f) the usefulness for assessing liquidity could be improved (see also point on restrictions on cash);
  - (g) restrictions on cash are not sufficiently disclosed;
  - (h) better information on liquidity would also involve better information on covenants;
  - (i) it might not be possible/useful to achieve 'cohesiveness' with the labelling in the statement of financial performance. For example, operating income is after depreciations, but cash flows from operating activities is before CapEx - and analysts did not want to change that;
  - (j) although it is a statement of cash flows, some non-cash items like leases would be useful to have in the statement as an investment;
  - (k) the indirect method to present cash flows from operating activities was generally most useful. Cases where the direct method was most useful included when there were significant business combinations. The direct method would also provide more granular information about the differences between operating cash flows and the related items in the statement of performance; and
  - (l) the few disclosure requirements lead to limited information and explanations in the notes.
- 14 The following issues were mentioned by non-users:
- (a) there are different views on what 'cash equivalents' consist of - it raises the question of whether it is more appropriate to only include 'cash' in the statement;
  - (b) in relation to whether a transaction would be a non-cash transaction or not, agent/principal relationships should be taken into account;
  - (c) it is difficult to compare the statement of cash flows between entities as the statements are prepared in different manners (e.g., different layouts and different manners to categorise cash flows);
  - (d) IAS 7 is an old standard that does not reflect the type of transactions that occur today; and
  - (e) the preference for the direct or indirect method to present cash flows from operating activities could depend on the user's background.

### Previous EFRAG FRB discussions

*June 2022 EFRAG FRB meeting (including the project on EFRAG's research agenda)*

- 15 When approving to include a project on cash flows to the EFRAG proactive research agenda at its June 2022 meeting, the EFRAG FRB it was agreed that the EFRAG Secretariat should work closely with the IASB to ensure no duplication and only value-adding efforts.

## IASB Background

- 16 In April 2022, following the Third Agenda consultation feedback received, the IASB added the project *The statement of Cash Flows and Related Matters* to the research pipeline of its 2022-2026 workplan.
- 17 In the [Feedback Statement](#) on the Third Agenda Consultation, published in July 2022, the IASB noted that, as part of this project, the IASB will consider whether the project should aim to review IAS 7 comprehensively or make more targeted improvements. The IASB's feedback statement referred to the issues identified by the respondents to the RFI as issues that could be considered in the project.
- 18 Many respondents to the IASB's RFI considered that it was a high priority to solve existing deficiencies, although they had mixed views about the nature and extent of those deficiencies. For instance, some supported a comprehensive review of IAS 7, while other respondents were in favour of a targeted approach on specific issues. These issues included both presentation issues (such as the classification of cash flows into operating, investing and financing activities) as well as other issues (including improving disclosures about non-cash movements, such as factoring of trade receivables and reverse factoring of trade payables). Additionally, the project may address some issues that arose in the Primary Financial Statements project but were outside its scope.



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