

Ms Françoise Flores
European Financial Reporting
Advisory Group (EFRAG)
35 Square de Meeûs
1000 Brussels
Belgium

**Ref: EFRAG's Short Discussion Series: The Statement of Cash Flows Issues
for Financial Institutions**

Dear Ms Flores,

DEAR FRANÇOISE,

The European Securities and Markets Authority (ESMA) thanks you for this opportunity to contribute to EFRAG's proactive activities. ESMA has considered the Invitation to Comment on the EFRAG's Short Discussion Series: *The Statement of Cash Flows Issues for Financial Institutions* ('Discussion Paper'). We are pleased to provide you with the following comments with the aim of improving the transparency and decision usefulness of financial statements.

ESMA welcomes EFRAG's Discussion Paper as an important contribution to the discussion on how to improve the information to enable investors to assess prospects for future net cash inflows of financial institutions. ESMA shares EFRAG's concerns about the relevance and usefulness of the information included in the statement of cash flows prepared by financial institutions in accordance with the requirements of IAS 7 *Statement of Cash Flows*, notably when prepared using the indirect method. While ESMA believes that the objective enshrined in IAS 7 remains relevant for all entities, we agree that in some cases application of IAS 7 requirements might fail to provide relevant information and can raise doubts about the effectiveness of achieving these objectives. This is the case in particular for situations where the underlying business activity is based on transfers of cash or cash equivalents (e.g. deposit taking activity).

ESMA highlights the importance of information about the cash flows of an entity that enables users of financial statements to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows. In our view such information is fundamental and its importance should be prominently reflected in the Conceptual Framework for Financial Reporting.¹ ESMA also notes that the statement of cash flows has been for a long time one of the primary financial statements and information provided in this primary statement is valued by investors across various industries. While ESMA highlights the need for relevant information in the financial statements, ESMA has

¹ Comment letter, The IASB's EDs Conceptual Framework for Financial Reporting and Update of References, ESMA, November 2015, ESMA/2015/1733, paragraphs 30-31

consistently argued against the introduction of industry-specific requirements, notably by modifying the requirement to present one of the primary financial statements. Consequently, ESMA tentatively favours the approach that retains the requirement to present the statement of cash flows for all entities but improves its content and presentation and accompanies it by a set of disclosures that provide relevant information for a particular type of entity.

ESMA encourages the discussion on how the existing requirements could be changed in order to provide more relevant information to users of financial statements (e.g. through the IASB research project on primary financial statements) and thus considers this Discussion Paper as a good starting point. However, we also encourage EFRAG to undertake further research and analysis to bring additional added value to the IASB standard-setting activities and to continue to influence the IASB thinking at this early stage. In particular, further research could analyse the usefulness of various solutions for users of financial statements and test whether examples of suggested disclosures or presentation could provide more relevant information on different types of financial institutions.

ESMA is of the view that EFRAG should focus first on identifying possible solutions for deposit taking institutions (credit institutions). In this context ESMA believes that the scope for any suggested solution needs to be further developed, as credit institutions might not represent a homogeneous group. Furthermore, while ESMA understands that similar concerns about IAS 7 might be raised in relation to life insurance companies, ESMA suggests that any solution in this area takes into account the new accounting requirements for insurance contracts and their presentation in the revised insurance contracts Standard.

ESMA acknowledges the analysis EFRAG has made in identifying potential improvements to the requirement to present the statement of cash flows by financial institutions and possible additional disclosure requirements that could provide relevant information to users. However, we are of the view that additional analysis is needed in order to identify the information that would be most relevant about various types of entities. Without the ambition to be comprehensive, ESMA notes that EFRAG could further analyse the relative merits of the following approaches for the preparation of statement of cash flows of certain financial institutions:

- management approach on liquidity management;
- considering the access to central bank financing and asset encumbrance in defining cash and cash equivalents of entities having direct access to central bank financing;
- hybrid method of presentation of statement of cash flows (i.e. combination of elements of direct and indirect methods); and
- relevance of regulatory disclosures required by Pillar III reporting for credit institutions or similar requirements required by Solvency II for insurance companies.

Finally, ESMA encourages EFRAG to reach out to investors and other users of financial statements in order to receive feedback on the information they consider most relevant and whether providing information similar to those currently provided as regulatory disclosure(s)



directly in the financial statements could be helpful for investors in order to assess an entity's prospects for future net cash inflows.

We would be happy to discuss all or any of these comments further with you.

Yours sincerely,

A handwritten signature in black ink, appearing to be "S. Maijoor".

Steven Maijoor