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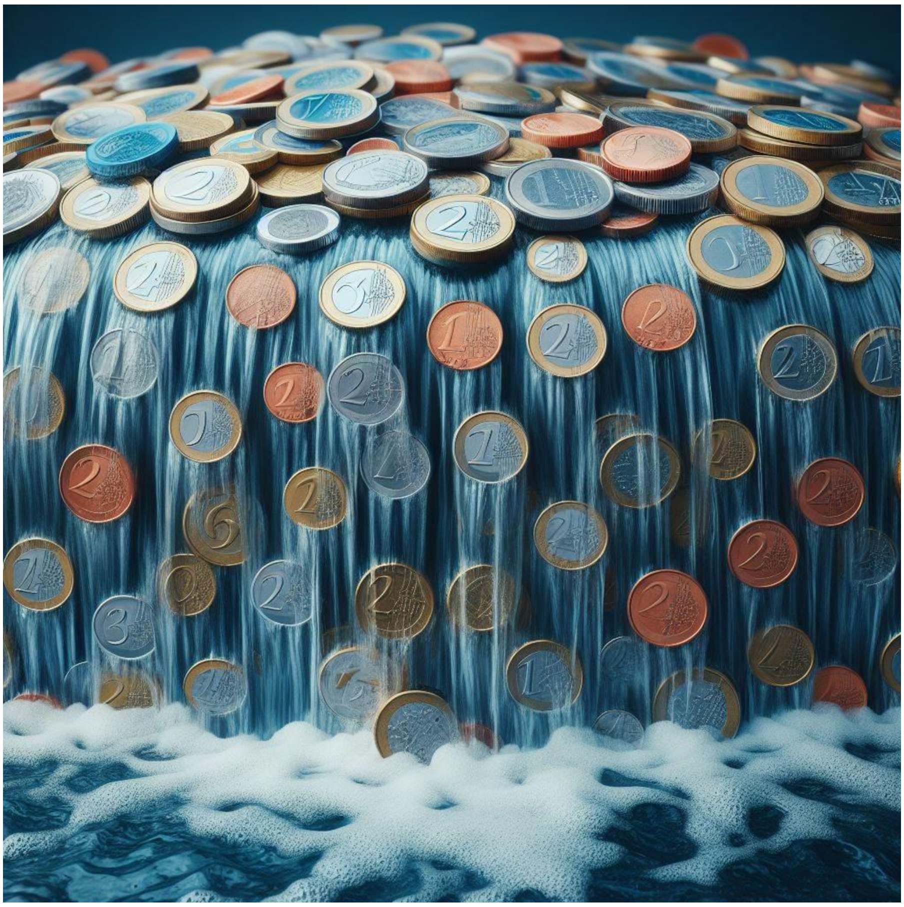
DISCUSSION PAPER

THE STATEMENT OF CASH FLOWS—OBJECTIVES, USAGES AND ISSUES

OCTOBER 2024



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Copies of the Discussion Paper are available from the EFRAG website.

EFRAG welcomes comments on its proposals via the 'Questions to Constituents' at the end of each section. Such comments should be submitted through the EFRAG website by clicking [here-insert hyperlink]

Comments should arrive no later than [Comment Deadline Date]. EFRAG will place all comments received on the public record unless confidentiality is requested.

EFRAG Research Activities in Europe

This paper is part of EFRAG's research work. EFRAG aims to influence future standard-setting developments by engaging with European constituents and providing timely and effective input to early phases of the IASB's work. Four strategic aims underpin proactive work:

- engaging with European constituents to understand their issues and how financial reporting affects them;
- influencing the development of International Financial Reporting Standards ('IFRS Standards');
- providing thought leadership in developing the principles and practices that underpin financial reporting; and
- promoting solutions that improve the quality of information, are practical, and enhance transparency and accountability.

More detailed information about our research work and current projects is available on the EFRAG website.

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Executive Summary

Purpose of this Discussion Paper

ES1 The main purpose of this Discussion Paper ('DP') is to list the issues that currently exist for statements of cash flows prepared in accordance with IAS 7 *Statement of Cash Flows*. However, as perceived issues with the statement of cash flows would depend on how the statement of cash flows is used, this DP first considers the objectives and usages of the statement of cash flows. Acknowledgement of the different perceived objectives of the statement of cash flows is also necessary when addressing the identified issues as providing more relevant information for one objective could impede the relevance of the information provided in the statement of cash flows for another objective.

Structure of the DP

ES2 Following the purpose of this DP as stated above, the DP first discusses the objectives and usages of the statement of cash flows. It then continues with discussing the issues for non-financial entities and an alternative to the statement of cash flows for non-financial entities. As there are particular issues with the statement of cash flows for financial institutions, these are considered in a separate chapter in the DP together with alternative reporting that might be more relevant to provide for these entities instead of a statement of cash flows. Finally, the DP discusses the benefits and problems of limiting amendments to IAS 7 to targeted improvements instead of performing a comprehensive review.

Objectives and usages of the statement of cash flows

ES3 Based on the descriptions in the IASB's Conceptual Framework for Financial Reporting (the 'Conceptual Framework') and IAS 7 of the benefits of information included in the statement of cash flows, the DP deduces the following objectives. These objectives are related to the main objective of financial reporting: providing information to help the primary users of financial reporting performing their assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity:

- Evaluating the changes in net assets. This includes the objective of understating the entity's business, and assessing accruals, which includes both assessing the closeness to cash of reported performance and assessing the current performance of the entity.
- Assessing the entity's financial structure, including liquidity and solvency.
- Assessing the entity's agility, which is how easily an entity can adapt to changing circumstances and opportunities. A high level of cash may make it easier for an entity to grab opportunities that may arise. On the other hand, the return on cash is often much lower than the return could get from having the cash invested or the return the shareholders could get from the invested money if they had been distributed as dividends.
- Assessing the entity's ability to generate cash and cash equivalents. Academic literature point in different directions on whether earnings or cash flow figures are best at predicting future cash flows. However, most, but not all, literature suggests that at least cash flow information has an added value.
- Comparing entities using different accounting treatments for the same transactions. It is not stated, neither in the Conceptual Framework, nor in IAS 7, but this could include assessing earnings management.

ES4 The statement of cash flows is also useful for the second main objective of financial reporting: to help the primary users of financial statements on their assessment of management's stewardship of the entity's economic resources. The statement of cash flows can both provide information for the assessment of the management's general performance and the management's cash management.

ES5 For all of the deduced objectives, the information included in the statement of cash flows should not be considered in isolation but together with other information included in the financial statements.

ES6 Input collected by EFRAG and academic literature indicate that the statement of cash flows is used for the deduced objectives listed in the DP. However, the extent to which the statement of cash flows is used varies significantly from one user to another.

ES7 For example, when looking at whether the statement of cash flows is used to assess accruals, input collected by EFRAG suggests that for some, increases in accruals is a red flag. However, academic research does indicate that investors over-estimate the persistence of the accrual component of earnings and under-estimate the persistence of the cash flow component of earnings. Accordingly, a trading strategy with a long position in low accrual firms and a short position in high accrual firms generates significant abnormal returns in the subsequent years.

ES8 For the assessment of the ability of an entity to generate cash and cash equivalents, some users base their assessments on cash flow estimates, but despite academic literature and prepares claiming that the cash flows presented by entities are better than the figures that users can calculate themselves from the statement of profit or loss and the statement of financial position, some users do calculate cash flows using their own models. However, some would, for example, make use of the capital expenditure figures from the statement of cash flows when calculating, for example, free cash flows.

ES9 As users thus use the statement of cash flows differently, it may be difficult to satisfy all users with one statement and priorities between the various objectives and usages will likely have to be made when amending IAS 7.

Issues with statement of cash flows for non-financial entities

ES10 The DP lists perceived issues with the statement of cash flows for non-financial entities. EFRAG has thus not limited the issues listed in the DP to those it assesses to be issues. The perceived issues relate to:

Perceived issues	Affect relevance of information for
• the definitions of 'cash' and 'cash equivalents'	• assessing liquidity • assessing solvency • assessing management's cash management
• cash flows of an agent	• all objectives
• non-cash transactions	
• payments by means of certain non-cash assets/own shares	• understanding the entity's business • assessing ability to generate cash and cash equivalents • comparing entities using different accounting treatments • assessing management's general performance
• transactions involving a financing component	• all objectives
• classification of cash flows	
• multiple component transaction	• all objectives
• investment categorisation linked to asset recognition requirements	• comparing entities using different accounting treatments
• presentation of related inflows outflows	• assessing current performance of the entity

	• assessing ability to generate cash and cash equivalents • assessing management's general performance
• operating versus finance leases	• assessing current performance of the entity • assessing ability to generate cash and cash equivalents • assessing management's general performance
• tax payments	• assessing current performance of the entity • assessing ability to generate cash and cash equivalents • assessing management's general performance
• disclosure requirements	
• preparation and classification choices	• all objectives
• Intercompany cash flows	• understanding the entity's business
• restrictions and location of cash	• assessing the entity's financial structure • assessing the entity's agility • assessing ability to generate cash and cash equivalents • assessing management's cash management
• liquidity and ability to service debt	• assessing the entity's financial structure • assessing the entity's agility • assessing ability to generate cash and cash equivalents • assessing management's cash management
• non-cash income	• understanding the entity's business • assessing current performance of the entity • assessing ability to generate cash and cash equivalents • assessing management's general performance
• non-recurring cash flows	• understanding the entity's business • assessing current performance of the entity • assessing ability to generate cash and cash equivalents • comparing entities using different accounting treatments • assessing management's general performance
• impact of business combinations	• assessing current performance of the entity • assessing ability to generate cash and cash equivalents • comparing entities using different accounting treatments • assessing management's general performance
• aggregation of information	• all objectives

ES11 As it appears from the table above, the perceived issues could affect the relevance of the information provided in the statement of cash flows for a range of the identified objectives of the statement. However, a solution that would enhance the relevance of the information with respect to one objective may decrease the relevance of the information provided for other objectives.

The definitions of 'cash' and 'cash equivalents'

ES12 The issues on what 'cash and cash equivalents' comprise relate to:

- Uncertainties about what is included in 'cash and cash equivalents'. For example, there are questions on what the meaning is of 'short-term maturity'; how much emphasis should be placed on the reference to 'three months'; and whether certain stable coins and central bank digital currencies would be cash and cash equivalents. There is also concern that there is implicitly a rebuttable presumption that an investment is not a cash equivalent. This could mean that similar types of investments could be chosen to be cash equivalents by one entity, if that entity would collect the necessary evidence to rebut the presumption, while another entity would not want to spend the efforts in collecting the necessary evidence and hence just consider the investment not to be a cash equivalent.

These issues could affect the comparability of the statement of cash flows between entities and also affect the understandability of what is actually included and therefore also to some extent affect the perceived faithful representation.

- The requirements on what is 'cash and cash equivalents' are considered by some not to result in the most relevant information. For example, the definition of what is cash equivalents is too restrictive for the assessment of solvency by credit agencies, which may have a broader focus and look at investments that could be converted into cash a six-months period. Also, if the management of liquidity in an entity is based on a broader scope of items, the current requirements may not provide the most relevant information for assessing management's stewardship of what it finds relevant to consider for the liquidity management. On the other hand, for the liquidity analysis, the relevance of the information is reduced by including items that cannot immediately be converted into cash.

Cash flows of an agent

ES13 There are differing views on whether the cash flows of a party acting in a transaction as an agent of the entity should be included in the statement of cash flows. For example, if an entity is requesting a bank to acquire an asset on its behalf for which the bank would also provide a financing solution. Similarly, there is divergence in practice on whether to include VAT cash flows in the statement of cash flows.

ES14 Not reflecting transactions performed by an agent in the statement of cash flows may not result in the most relevant and comparable information.

Excluding non-cash transactions from the statement of cash flows

ES15 The statement of cash flows does not include non-cash transactions. Some consider that this does not result in comparable information. For example, some consider that the purchase of an asset by the transfer of own shares or crypto currencies is economically the same as first selling own shares or crypto currencies and then pay for the asset in cash. However, while the first transaction would not be reflected in the statement of cash flows (the acquisition would not appear from the capital expenditures), the latter transaction would. Similarly, if an asset is purchased by assuming a directly related financing liability this acquisition may not appear from the statement of cash flows whereas it would appear if obtaining the financing and acquiring the asset would be done separately.

ES16 Some also consider that excluding certain non-cash transactions (e.g., the purchase of an asset by the transfer of own shares or the sale of goods and services for cryptocurrencies) does not result in the most relevant information for the objectives related to: understanding the entity's business (particularly if the statement is used in isolation for this purpose); assessing the ability of the entity to generate cash and cash equivalents (depending on how the information included in the statement of cash flows is used for this objective (e.g., if the focus is on CapEx)); comparing, to some extent, entities using different accounting treatment for the same transactions (as some transactions would otherwise not be reflected in the statement); and assessing management's general performance. On the other hand, including such non-cash transactions might reduce the relevance of the statement for understanding the entity's business (as non-cash transactions would appear as cash transactions); the assessment of closeness to cash; assessing the entity's financial structure; assessing the entity's ability to affect the amount and timing of cash flows; assessing the ability of the entity to generate cash and cash equivalents (if the focus is on the cash flows the entity has actually generated); comparing entities using different accounting treatments (as requirements would have to be introduced on how to reflect (mainly the amount to be attached to) the cash flows that have not taken place); and the management's cash management. Reflecting cash flows that have not taken place could also be argued not to result in a faithful representation.

ES17 Not reflecting as an investment or an outflows related to operating activities (depending on the circumstances) an asset purchased by assuming a directly related liability affects the relevance and faithful representation of the information similar to not reflecting cash flows of an agent (see above).

Classification of cash flows

ES18 The amendments to IAS 7 following the issuance of IFRS 18 *Presentation and Disclosure in Financial Statements* removed some of the options on how to classify interests and dividends, but there is divergence in practice in relation to the classification of many other types of transactions, including (but not limited to): payments to unfunded defined benefit pension schemes; cash received from factoring of trade receivables, cash received from government grants; cash payments related to the purchase of an asset on deferred payment terms; cash received in a sale and lease back arrangement where the transaction qualifies as a sale; payments of variable consideration; and how to classify cash received and cash payments related to derivatives that are 'collateralised-to-market'.

ES19 These differences in classification result in the statements of cash flows between entities not being comparable.

ES20 The requirements on classification are also considered by some not to always result in the most relevant information. For example, if an entity has a supplier finance arrangement which extends the purchaser's (the entity's) payment terms, it could be that all payments related to goods and services acquired by the entity would be presented as financing cash flows. This may not result in the most relevant information, for example when assessing the entity's ability to generate cash from its operations. The effect on relevance and faithful representation of this issue and a possible solution requiring entities to present the cash flows from a supplier finance arrangement similar to if the entity would have borrowed money and paid its suppliers with this money, would be similar to the effects listed for cash flows of an agent.

ES21 In relation to the classification requirements some do also not think that it results in the most relevant information to:

- Only classify expenditures that are capitalised as cash flows from investing activities. It is considered that this result in operating cash flows being understated. This could affect the relevance of the statement of cash flows for comparing entities applying different accounting policies (which is one of the deduced objectives of the statement of cash flows). It could also affect understanding the entity's business; assessing the ability of the entity to generate cash and cash equivalents; and assessing management's general performance. On the other hand, any alternative might not result in more relevant information for the stated objectives and may also reduce the relevance of the statement of cash flows for assessing the closeness to cash.
- Classify inflows as resulting from operating activities, while the related outflows are presented under another activity, or vice versa. This can happen under reverse factoring arrangements, under which payments related to goods and services of suppliers can be classified as financing outflows and in relation to government grants. This can affect the relevance of the information for, for example, assessing the current performance of the entity (e.g., in case of reverse factoring arrangements it can seem that an entity's operating activity is generating more cash and cash equivalents, than is the case); assessing the entity's ability to generate cash and cash equivalents; and assessing general performance. However, requiring related inflows and outflows to be included within the same category could reduce the relevance of the information for assessing the entity's financial structure (if it would mean that certain cash flows would not be reflected in the category best reflecting the activity to which they relate); assessing the entity's ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities; assessing the ability of the entity to generate cash and cash equivalents; and assessing the management's cash management.
- Not distinguishing between finance and operating leases as in the previous IAS 16 *Leases* standard. Not distinguishing between operating and financing leases reduce the relevance of the information for the

objective of assessing the ability of the entity to generate cash and cash equivalents. On the other hand, re-introducing a distinction between finance and operating lease could reduce the relevance of the statement of cash flows for assessing an entity's financial structure and assessing management's cash management.

- Classifying by default payment of taxes under operating activities and not having a separate category for taxes which would align better with IFRS 18. This could affect the relevance of the information for assessing the current performance of the entity; for assessing the ability of the entity to generate cash and cash equivalents and for assessing management's general performance.

Disclosures requirements

ES22 Compared with many other IFRS Accounting Standards, IAS 7 does not include many disclosure requirements, and some express a wish for additional information on:

- preparation and classification choices made by the entities
- intercompany cash flows
- restrictions on cash and where cash is placed in a group. There are currently some requirements on disclosures on restrictions of cash, but some users do not consider they get sufficient information on, for example, the percentage of the consolidated cash that is available to the parent entity
- liquidity and ability to service debt – including information helping assessing liquidity mismatches
- non-cash income
- non-recurring cash flows
- impacts of business combinations

ES23 Also, there are some indications that some struggle to understand the connections between the statement of profit or loss, the statement of financial position and the statement of cash flows, for these some reconciliations could be useful.

Aggregation of information

ES24 Some consider that IAS 7 allows for too much flexibility on how to aggregate information in the statement of cash flows. This has resulted in the level of disaggregation being insufficient for the statement of cash flows from some entities. However, the principles of aggregation and disaggregation of IFRS 18 should help entities in determining the line items to present in the statement of cash flows, and the material information to be disclosed in the notes.

ES25 Some have expressed a wish to have capital expenditures related to maintenance presented separately from capital expenditures related to growth. Other have, however, questioned whether such information can be provided in a manner that would be useful.

ES26 On users' wish list is also a separation of dividends to controlling and non-controlling interests.

Definitions of measures

ES27 To have more consistent disclosures and presentations, it has been suggested to define:

- working capital;
- net debt (this is particularly needed if the statement of cash flows, as discussed below, would be replaced by an explanation of changes in net debt);
- free cash flows.

ES28 Also, if preparers should be able to distinguish between capital expenditures used for growth and maintenance (see paragraph ES25 above) these different types of capital expenditures would need to be defined.

Cohesiveness with other primary financial statements

ES29 Differences between the categorisation used in the three primary statements can cause confusion. Particularly after IFRS 18 where the categories operating, investing and financing are also used in the statement of profit or loss. It was mentioned above that the manner in which tax payments are presented in the statement of cash flows could be changed. However, a complete alignment may not be desirable. For example, input from users indicates that they would prefer depreciations to be included in the operating category in the statement of profit or loss, while the corresponding capital expenditures should be presented under investment activity in the statement of cash flows. As a complete alignment does not seem desirable, it could be considered to amend the categories in IFRS 18 and IAS 7 so that they would not carry similar names but have different content.

Presentation of cash flows from operating activities

ES30 Allowing both the direct and indirect presentation of cash flows from operating activities affects comparability and also the type of information on accruals that will be available to users. Although academic research generally seems to favour the direct presentation, the European users EFRAG has consulted prefer the indirect presentation.

Alternative to the statement of cash flows for non-financial entities

ES31 Input received by EFRAG has suggested a net debt statement could be considered as an alternative to the statement. Some users consider a net debt statement more useful when, for example, estimating enterprise value. Some of the issues with the current statement of cash flows would be solved by instead requiring a statement of net debt. However, an issue with a statement of net debt is that there is currently no definition of net debt. The DP also presents a statement of changes in working capital; a statement of changes in other liquid assets; and a statement of changes in assets used for liquidity management as possible alternatives/supplements to the statement of cash flows that may be considered.

The statement of cash flows for financial institutions

ES32 As described in EFRAG's Discussion Paper *The Statement of Cash Flows: Issues for Financial Institutions* from 2015 and confirmed by the feedback received in response to that discussion paper, the relevance of the statement of cash flows of banks and insurance companies (and other financial institutions) is questionable. This being said, there are, however, some users who do use it.

ES33 Considering the questionable relevance of the statement of cash flows from financial institutions, alternatives might be considered. Examples of alternatives that have been brought to the attention of EFRAG include: presentation of regulatory ratios (for banks); information on liquidity (for banks and insurance companies); information about dividend payout capacity (for banks and insurance companies); information about the flow of (regulatory) capital (for banks (and insurance companies)); removal of the categories in the statement of cash flows (for banks and insurance companies); information about the collection and uses of cash resources (for banks and insurance companies); standardised stress test scenarios (for banks and insurance companies); and information on cash flows related to interests and loan originations and repayments (for banks).

Targeted improvements or a comprehensive review?

ES34 Many of the issues identified with the statement of cash flows could be addressed by targeted improvements. It could thus be expected that some of the current issues could be addressed within a relatively short time horizon. Targeted improvements may, however, not solve more fundamental issues, and the question therefore arises whether fixing some issues or comprehensively reconsidering the statement of cash flows (or something instead of a statement of cash flows) should be the way forward. This DP does not provide a preliminary view on this question but is encouraging stakeholders to provide their views on this and the other questions included in the DP.

QUESTIONS TO CONSTITUENTS

EFRAG invites comments on all matters in this Discussion Paper, particularly in relation to the questions set out below. Comments are more helpful if they:

- address the question as stated;
- indicate the specific paragraph reference to which the comments relate; and/or
- describe any alternative approaches that should be considered.

All comments should be received by [Submission date].

Question 1 Objectives of the statement of cash flows

Chapter 2 of this DP lists objectives of the statement of cash flows. The most important being:

- Evaluating the changes in net assets (Objective 1)
    - Understanding the entity's business (Objective 1a)
    - Assessing closeness to cash (Objective 1b.1)
    - Assessing current performance of the entity (Objective 1b.2)
- Assessing the entity's financial structure (Objective 2)
    - Assessing liquidity (Objective 2a)
    - Assessing solvency (Objective 2b)
- Assessing the entity's ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities (Objective 3)
- Assessing the ability of the entity to generate cash and cash equivalents (Objective 4)
- Comparing entities using different accounting treatments for the same transactions (Objective 5).
- Assessing management's stewardship (Objective 6)
    - Assessing management's general performance (Objective 6a)
    - Assessing management's cash management (Objective 6b)

Do you agree with these objectives? Do you think there are additional objectives?

As indicated in Chapter 4, solutions to some of the current issues with how the statement of cash flows is prepared in accordance with IAS 7 may benefit the usefulness of the statement of cash flows for some objectives while harm the usefulness of the statement for other objectives.

Do you think that some objectives of the statement of cash flows are more important than others? If so, which are more/less important?

Question 2 **Usages of the statement of cash flows**

In Chapter 2 the DP lists manners in which the statement of cash flows is used by primary users of the financial statements. Are there additional manners of using the statement of cash flows than those listed?

Question 3 **Issues with the statement of cash flows for non-financial entities**

Chapter 3 of the DP lists issues with how the statement of cash flows is prepared in accordance with IAS 7 and links these issues to the objectives they affect and the qualitative characteristics of useful financial information affected. EFRAG has not made an assessment of the validity of the various stated issues.

Do you agree with the issues listed? Do you think there are additional issues than those listed? If so, which?

How would you rate the various issues identified (low, medium or high priority)?

Some of the issues identified in relation to cash flows of an agent; excluding non-cash transactions from the statement; aggregation of information; and cohesiveness with other primary financial statements could either be addressed by amending the requirements on the information to be displayed in the statement of cash flows or by introducing additional note disclosure requirements. For the issues you consider should be addressed, how do you consider they would be best addressed (changes to the information presented in the statement of cash flows or additional note disclosures)?

Question 4 **Non-cash transactions**

Chapter 4 considers two types of non-cash transactions:

- Transactions in which no cash or cash equivalents are involved such as the acquisition of PPE by means of own shares
- Multiple components transactions that involve cash or cash equivalents, but which result in cash flows to and from an entity being reduced compared to a situation where the various components have not been bundled

Do you think that some non-cash transactions should be presented in the statement of cash flows? If so, which?

Instead of presenting non-cash transactions in the statement of cash flows, do you think additional disclosures should be provided about these transactions?

Question 5 Alternatives to the statement of cash flows for non-financial entities

Chapter 5 of the DP presents a statement of net debt (or a net debt reconciliation) as an alternative to the statement of cash flows. Would you support the statement of cash flows being replaced by a statement of net debt?

Question 6 The statement of cash flows for financial institutions

In 2015 EFRAG consulted on whether the statement of cash flows should be replaced by other requirements or should be improved. Do you consider that anything has changed since 2015 which would justify for this issue being reconsidered?

Question 7 Targeted improvements or a comprehensive review?

Chapter 7 shortly lists benefits and disadvantages of dealing with (some) of the issues with how the statement of cash flows is currently prepared under IAS 7 by targeted improvements, a comprehensive review or a phased approach, respectively.

Which approach would you prefer and why?

If you consider that the IASB should make targeted improvements, which issues do you think should/should not be addressed?

CHAPTER 1: BACKGROUND

Following the 2021 consultation on EFRAG's research agenda, EFRAG decided to include on its research agenda a project on the statement of cash flows. The project should be helpful for the IASB's project on the statement of cash flows and related matters. This Discussion Paper lists identified objectives and usages of the statement of cash flows and the related perceived issues with how statements of cash flows are currently prepared in accordance with IAS 7. The Discussion Paper also provide an assessment of whether the issues can be addressed by targeted improvements, or a comprehensive review of IAS 7 would be necessary.

Introduction

1.1 Following the 2021 consultation on EFRAG's research agenda, EFRAG decided to include on its research agenda a project on the statement of cash flows. The project aims to provide input to the IASB, which has also decided to include a project on its agenda following its Request for Information (RfI) on its Third Agenda consultation.

1.2 To be helpful for the IASB's project, it was deemed useful to identify the issues that currently exist for statements of cash flows prepared in accordance with IAS 7 *Statement of Cash Flows*. As perceived issues with the statement of cash flows would depend on how the statement of cash flows is used, EFRAG considered that objectives and usages of the statement of cash flows needed to be identified so that the identified issues would be linked to these objectives and usages.

1.3 Providing a list of perceived current issues with the statement of cash flows could give the impression that the IASB could solve these through targeted improvements. Therefore, EFRAG considered it necessary to discuss whether this would be the best approach to address the current issues or a comprehensive review of IAS 7 would be necessary to deal with the issues in a satisfactory manner.

Scope and objective of the Discussion Paper

1.4 The objective of this Discussion Paper ('DP') is to:

a) List identified objectives and usages of the statement of cash flows prepared in accordance with IAS 7.

b) List identified issues with the statement of cash flows prepared in accordance with IAS 7.

c) Discuss whether issues with the statement of cash flows can be addressed by targeted improvements or a comprehensive review of IAS 7 would be necessary to deal with the issues in a satisfactory manner.

1.5 When considering the objectives and usages of the statement of cash flows, only the needs of the primary users of general-purpose financial reports as described in the IASB's *Conceptual Framework for Financial Reporting* paragraph 1.5 (i.e., existing and potential investors, lenders and other creditors who must rely on general purpose financial reports erfor much of the financial information they need) are considered.

1.6 The DP does not provide assessments of identified objectives, usages and issues of/with the statement of cash flows. Accordingly, the DP may, for example, list examples of how the statement of cash flows is used, while some may consider to be an inappropriate use of the statement.

1.7 Input on the objectives, usages, and issues with the statement of cash flows has been collected from literature[1], interviews, closed and open outreach events. Although this DP, in a few places, includes indications of the frequency of which a given objective, usage or issues has been identified, it is not the purpose of the DP to provide statistical information on how often a given objective, usage or issue has been identified. The objective is instead to be as complete as possible in listing objectives, usages and issues related to the statement of cash flows, although these objectives, usages and issues may not be generally shared.

Structure of the Discussion Paper

1.8 This DP first lists the identified objectives of the statement of cash flows and then presents some input collected by EFRAG from consultations with users of financial statements and from literature on whether the statement of cash flows is used for the objectives listed (Chapter 2). This is followed by listing the issues, EFRAG is aware of, with how the statement of cash flows is currently prepared on IAS 7 (Chapter 3). As part of describing these issues, it will be considered which of the objectives of the statement of cash flows are affected by the issues and whether addressing the issue could potentially have consequences for the statement of cash flows' ability to meet other of the objectives listed in the DP. The DP does not claim that addressing an issue would necessarily have unwanted effects, however, it marks issues that might arise depending on how an issue would be addressed.

1.9 Some of the input collected suggests that there may be alternatives to the current statement of cash flows that could provide more useful information in some cases. These alternatives for non-financial entities are presented separately in Chapter 4.

1.10 As noted in EFRAG's Discussion Paper *The Statement of Cash Flows, Issues for Financial Institutions*, and confirmed by the feedback received during the consultation period, a generally held view is that the statement of cash flows is not useful for financial institutions. Chapter 5 accordingly considers separately the statement of cash flows for financial institutions.

1.11 Chapter 6 includes a discussion on whether the identified issues can be dealt with through targeted improvements, or a comprehensive review of IAS 7 would be necessary to address the issues in a satisfactory manner.

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[1] Some of the input collected for this DP has been collected by Zielke Research Consult.

CHAPTER 2: OBJECTIVES/PURPOSE AND USAGES OF THE STATEMENT OF CASH FLOWS FROM NON-FINANCIAL ENTITIES

This Chapter lists different objectives of the statement of cash flows and provides some insight into whether the statement of cash flows is used for these objectives. There are different manners in which the objectives of the statement of cash flows could be listed. As the purpose of this DP is to list issues with the current requirements in IAS 7, it has been chosen to consider as objectives, the benefits of cash flow information presented in the Conceptual Framework for Financial Reporting and IAS 7 which are considered to be:

- *Providing information for the assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity*
    - *evaluating changes in net assets (including understanding the entity's business, assessing closeness to cash, and assessing current performance of the entity);*
    - *assessing the entity's financial structure (including assessing liquidity and solvency);*
    - *assessing the entity's ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities;*
    - *assessing the ability of the entity to generate cash and cash equivalents; and*
    - *comparing entities using different accounting treatments for the same transactions and events.*
- *Assessing management's stewardship (including management's general performance and cash management).*

Input collected by EFRAG indicates that the statement of cash flows is used for most of the objectives listed. However, the input also indicates that the usage varies greatly from user to user.

Benefits of cash flow information

2.1 The objective of the statement of cash flows is often stated by reference to what it shows, for example:

a) The primary objective of a statement of cash flows is to provide relevant information about the cash receipts and cash payments of an entity during a period[2].

b) The statement of cash flows shows where an entity got its money from and what it did with the money[3].

2.2 Neither the IASB Conceptual Framework for Financial Reporting nor IAS 7 thus state a clear objective of the statement of cash flows. Instead, they explain how the information included in the statement of cash flows can be useful.

[2] ACS 230-10-10-1.

[3] Comment made at an EFRAG round table on the statement of cash flows.

Conceptual Framework for Financial Reporting

2.3 According to paragraph 1.2 of the Conceptual Framework for Financial Reporting (the 'Conceptual Framework')

> [t]he objective of general-purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.

2.4 Paragraph 1.3 of the Conceptual Framework explains that the decisions relating to providing resources to the entity depend on the returns that existing and potential Investors, lenders and other creditors expect. Expectations on returns depend on:

a) an assessment of the amount, timing and uncertainty of (the prospects for) future net cash inflows to the entity; and

b) an assessment of the management's stewardship of the entity's economic resources.

2.5 To form these expectations and assessments, existing and potential investors, lenders and other creditors need, according to par. 1.4 of the Conceptual Framework, information about:

a) the economic resources of the entity, claims against the entity and changes in those resources and claims;

b) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's economic resources.

2.6 The Conceptual Framework notes (paragraph 1.12) that information about:

a) an entity's economic resources and the claims against the reporting entity; and

b) the effects of transactions and other events that change a reporting entity's economic resources and claims

is useful for the information need described in paragraph 2.5a) above.

2.7 On the usefulness of reporting an entity's cash flows during a period, the Conceptual Framework considers (paragraph 1.20), that this information helps users to assess both of the information needs listed in paragraph 2.5 above. It is noted that the statement of cash flows

> indicates how the reporting entity obtains and spends cash, including information about its borrowing and repayment of debt, cash dividends or other cash distributions to investors, and other factors that may affect the entity's liquidity or solvency. Information about cash flows helps users understand a reporting entity's operations, evaluate its financing and investing activities, assess its liquidity or solvency and interpret other information about financial performance.

IAS 7

2.8 IAS 7 states that the objective of the Standard (not the objective(s) of the statement of cash flows) is to:

> […] require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows which classifies cash flows during the period from operating, investing and financing activities.

2.9 Similar to the Conceptual Framework, IAS 7 explains why the information provided in the statement of cash flows is useful. Under the heading 'objectives' it states that:

> Information about the cash flows of an entity is 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 need of the entity to utilise those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation.

2.10 Under the heading 'Benefits of cash flow information' paragraph 4 of IAS 7 further states that[4]:

> A statement of cash flows, when used in conjunction with the rest of the financial statements, provides information that enables users to evaluate the changes in net assets of an entity, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities. Cash flow information is useful in assessing the ability of the entity to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different entities. It also enhances the comparability of the reporting of operating performance by different entities because it eliminates the effects of using different accounting treatments for the same transactions and events.

Deduced objectives

2.11 A few differences can be observed between the benefits of the statement of cash flows as stated in the Conceptual Framework versus IAS 7. The Conceptual Framework thus does not explicitly refer to the usefulness of the statement of cash flows in relation to assessing the entity's ability to affect the amounts and timing of cash flows to adapt to changing circumstances and opportunities and for comparing entities. These objectives could, however, be included in the more general references in the Conceptual Framework, to 'other information about financial performance'.

2.12 Based on both the Conceptual Framework and IAS 7, it might be deducted that the statement of cash flows does not have a separate purpose, but its purpose is, together with other information in the financial statements to provide information that is useful for:

<u>Assessment of the amount, timing and uncertainty of future net cash inflows</u>

a) Evaluating the changes in net assets (including evaluation of performance) (Objective 1);

b) Assessing the entity's financial structure, including (Objective 2):

  (1) Liquidity; and

  (2) Solvency;

[4] For the US, ACS 230 states that the "information provided in a statement of cash flows, if used with related disclosures and information in the other financial statements, should help investors, creditors, and others (including donors) to do all of the following: a. Assess the entity's ability to generate positive future net cash flows b. Assess the entity's ability to meet its obligations, its ability to pay dividends, and its needs for external financing c. Assess the reasons for differences between net income and associated cash receipts and payments d. Assess the effects on an entity's financial position of both its cash and noncash investing and financing transactions during the period" (ACS 230-10-10-2). Compared with the deduced objectives, the purposes stated in ACS 230 may put less emphasis on assessing the agility of an entity (Objective 3), comparing entities (Objective 5) and assessing management's stewardship (at least as a separate objective) (Objective 6).

c) Assessing the entity's ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities (Objective 3);

d) Assessing the ability of the entity to generate cash and cash equivalents (including cash dividends and other cash to investors) (Objective 4);

e) Comparing entities as it eliminates the effects of using different accounting treatments for the same transactions and events (Objective 5);

Assessment of the management's stewardship

f) Assessing management's stewardship (Objective 6).

2.13 These purposes, which are related, are further explained below together with input collected by EFRAG and academic literature on whether the statement of cash flows is used for the listed purposes/objectives. Generally, the input collected supports the statement in paragraph 2.12 above, that the benefits of the statement of cash flows arise when the statement is used in conjunction with the rest of the financial statements.

2.14 The input collected, however, also shows variation in the usages of the statement of cash flows by users of financial statements – including the same types of users. Thus, some users do not use the statement of cash flows or barely use it[5], while others use it more extensively. Also, some input collected suggests that some users are more likely to pay attention to the information in the statement of cash flows if the financial health of a given entity is poor, compared to when it is good.

2.15 Changes in cash and cash equivalents and changes in net assets generally, could, to some extent be estimated based on the statement of financial position and the statement of financial performance. However, some academic research has found that the statement of cash flows provides additional information than the information that can be derived from the other two primary financial statements[6]. In addition, EFRAG has heard from users that the benefit of the statement of cash flows is that the information is more easily available compared to if users should have tried to derive it from the other parts of the financial statements.

Objective 1: Evaluating the changes in net assets

2.16 Stated in a simplified manner, one of the objectives of the statement of cash flows is to explain why an entity's cash position has not changed with the same amount as the profit or loss for the period. The statement thus provides a link to the statement of financial performance and to the statement of financial position.

2.17 Input collected by EFRAG also indicates that the statement of cash flows is used to evaluate changes in net assets. Surveys conducted in the US and Australia have found similar evidence.

[5] Examples of a very light use of the statement, includes users who only use the information in the statement on capital expenditures or taxes paid.

[6] See, for example, Mitchell et al. (1995).

2.18 FASB Investor Survey in 2022 showed that majority of respondents agreed that the current statement of cash flows (in the US) provides information needed for analysing changes in working capital (FASB 2023b).

2.19 An older academic study based on an Australian survey[7] similarly found that preparers of financial statements considered that the information presented in the statement of cash flows would be useful for investors for monitoring changes in the financial position.

2.20 The statement of cash flows shows, for the period between two accounting periods, the sources from which the entity has received its resources (for the statement of cash flows: its cash and cash equivalents) and how it has used these resources (cash and cash equivalents). This information can be used for:

a) understanding the entity's business (Objective 1a)

b) assessing accruals (Objective 1b)

Objective 1a: Understanding the business

2.21 As mentioned above, the statement of cash flows provides information on the sources of the entity's resources. For example, does the entity generate the resources it uses for maintaining its business or for growing from its operations, from selling its fixed assets or from obtaining new debt or, for example, from requiring payments from customers in advance and paying suppliers in arrears. This information is useful for understanding the business. A business models characterised by a long cash conversion cycle have limited capacity to finance their own growth with the cash from their operation. Entities with such business models are therefore dependent on finding external sources of financing.

2.22 The statement of cash flows can also provide information about at which stage in its life cycle an entity is at[8]. Negative free cash flows may indicate that the entity is at the growth stage. This can be associated with the high capital expenditures and other investments. Mature entities, on the other hand, have positive free cash flows, whereas entities which are at the declining stage have lower levels of capital expenditures, which increase the positive free cash flows[9], however, operating cash flows may also decrease as the entity may have to lower the prices of its products.

2.23 Information about which stage of its life-cycle an entity is at can, for example, help users of financial statements to[10]:

a) better assess growth rates and forecast horizons in valuation models;

b) better understand how economic fundamentals affect the level and convergence properties of future profitability; and

[8] The life cycle of an entity may composite of many overlapping, but distinct product life cycle stages.

[9] Greuning et al. (2013).

[10] Dickinson (2011).

c) identify firms where potential unidentified risk factors and/or market mispricing exist based on differences in life cycle stage.

2.24 The statement of cash flows can also provide information on the ‘dynamics’/’rhythm’ of a business including its cash conversion cycle and if prepared for interim reporting periods, information on seasonality in cash inflows and outflows.

2.25 The input collected by EFRAG also indicates that the statement of cash flows is used by some to understand ‘the rhythm’, cash flow dynamics[11], business cycle of an entity, the stage at which an entity is in its life cycle and the cash conversion. In the IFRS Foundation’s Investor Perspective, IASB member Nick Anderson has thus also stated that:

Experienced analysts and portfolio managers would often advise those new to the profession to ‘follow the cash and you will understand the business’[12].

2.26 The information included in the statement of cash flows, together with information about movements in debt, can be used to understand the sources of an entity’s finance and how those sources have been used over time[12].

2.27 Understanding the business is relevant for both assessing the entity’s ability to service debt and for investment decisions[12].

2.28 Literature also suggests that some use information on capital expenditures, which appear from the statement of cash flows, to assess the capital intensity of an entity[13]. Capital intensity is then calculated as, for example, capital expenditure divided by revenue. The capital intensity is then used to assess how much an entity relies on tangible versus intangibles. It is considered that entities relying on physical assets like real estate, factories and machinery are unlikely to earn reliably superior returns on their invested capital over the long term[13].

2.29 Although the statement of cash flows is used to provide insight of an entity’s life cycle, research indicates that the market does not fully capture information provided by the life cycle proxy such that mature entities earn positive excess returns in the year following life cycle stage assignment. This might indicate that investors underestimate the persistence of the elevated profitability of mature firms and instead expect their profitability to mean-revert to a ‘normal’ level[14].

Objective 1b: Assessing accruals

2.30 The statement of cash flows can be used for assessing accruals. This can comprise of both:

a) Assessing the closeness of earnings to cash (Objective 1b.1). Such assessments can support assessments of how representative earnings figures are for future earnings. This is also sometimes referred to as assessing the sustainable earnings power or as assessing the quality of earnings, but the term ‘quality of earnings’ has several meanings.

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[11] Input collected by EFRAG and mentioned by Anderson (2023).

[12] Anderson (2023).

[13] Elmars (2007).

[14] Dickinson (2011).

Information on accruals can also be estimated using information in the statement of financial position. Academic research, however, indicates that investors use accrual information more efficiently when the information is also provided by a statement of cash flows, particularly less sophisticated users seem to benefit from this information[15].

b) Assessing the current performance of an entity (Objective 1b.2). As noted in relation to Objective 1a, the statement of cash flows can be used to understand the entity's business, but it can also be used to assess the performance. For example, has the entity become more effective in collecting receivables and has the contract liabilities increased or decreased (indicating increases/decreases in future revenue (or problems fulfilling contracts).

2.31 Input received by EFRAG from users has confirmed that the statement of cash flows is used by some users to assess how sustainable reported earnings is (e.g., the closeness to cash). Some users thus consider increases in accruals as a 'red flag'. For example, if increases in operating or net profit is reported but cash flows from operating activities have not increased. The Enron case has sometimes been referred to as an illustration of why it is important to consider the sustainability (or quality) of reported earnings.

2.32 The Australian study previously mentioned found that the statement of cash flows provided useful information for lenders for assessing overall company performance, operating performance and the quality of net income. This also applied to the usefulness for investors with the exception that the assessments of the usefulness for assessing the quality of net income were not significant.

2.33 Although the statement of cash flows is used by some users to assess accruals, some academic studies indicate that high levels of accruals are not reflected in sell-side analysts' earnings forecasts and investors over-estimate the persistence of the accrual component of earnings and under-estimate the persistence of the cash flow component of earnings. Accordingly, a trading strategy with a long position in low accrual firms and a short position in high accrual firms generates significant abnormal returns in the subsequent years.

Objective 2: Assessing the entity's financial structure

2.34 The statement of cash flows can provide information about an entity's financial position. The information related to the financial position of an entity can enable investors to understand whether an entity has potential to generate future net cash flows which will be used in meeting the various types of financial obligations, the ability to return money to investors and assess whether there is a need for the entity to avail external sources of finance in order to fund operations[16].

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[15] See Miao et al. (2016).

[16] See, for example, Munter (2023).

2.35 Information about the entity's financial position is available from the presentation of the related cash inflows and cash outflows under cash flow from operating activities, cash flow from investing activities and cash flow from financing activities. Cash flow information provided in this manner explains how an entity has used the financial resources in the form of cash outflows and how an entity has been able to accumulate financial resources in the form of cash inflows. This information enables users of the statement of cash flows to evaluate both the liquidity and solvency position of an entity by using relevant cash flow ratios suitable for assessing liquidity and solvency respectively[17].

2.36 The following sub-sections explain how the statement of cash flows can be used to assess the liquidity and solvency of an entity. However, as it will appear the distinction between 'liquidity' and 'solvency' may not be clear and when possible, this DP will therefore refer to the general objective of assessing an entity's financial structure.

2.37 Input collected by EFRAG indicates that information in the statement of cash flows is, together with other information, used to assess the financial robustness of an entity, including its credit worthiness[18]. It is used to assess whether an entity has generated enough cash inflows to meet its short-term and long-term debt obligations. The information is also important for bond analysts to enable them to assess whether an entity's liquidity position would be strong enough during the next refinancing period to attract funds.

2.38 The information included in the statement of cash flows, together with information about movements in debt, can be used to better assess a company's ability to service and repay its debts[19].

2.39 Academic literature[20] notes that the cash flow analysis is the most important single factor for credit rating decisions[21]. In addition to aiding in determining the trends and sustainability of cash flow generation, it is used to separate cash flows from operating activities, from investing activities and financing activities and to identify potential distortions and future volatilities.

2.40 Debt analysts and rating agencies use a number of ratios, which are also found in loan agreements. However, instead of using figures from the statement of cash flows credit analysts as well as agencies usually prefer EBIT and EBITDA[22]. For example, to assess the repayment period (if operating cash flows is used exclusively for debt repayment), the ratio net debt (the difference between interest-bearing liabilities and cash and cash equivalents) over EBITDA is used. Similarly, to assess the interest coverage ratios EBIT or EBITDA are related to the interest expense[22]. However, an alternative to assess the repayment period, from which figures from the statement of cash flows is also seen. Under this alternative operating cash flows before changes in working capital (funds from operation) is also used instead of EBITDA[22].

[17] See, for example, Gebhardt & Mansch (2012) and Noor et al. (2012).

[18] Information collected by EFRAG.

[19] Anderson (2023).

[20] Gebhardt & Mansch (2012).

[21] As noted in paragraph 2.40, academic literature, however, also indicates that creditors focus more on earnings figures than on cash flow figures.

[22] Gebhardt & Mansch (2012).

2.41 The Australian study previously mentioned[23], found that the statement of cash flows provided useful information for lenders for evaluating solvency, ability to service debts and liquidity. For investors it was assessed to provide useful information on liquidity. The study did not provide significant results on whether the statement was considered useful for investors to evaluate solvency and the ability to service debts.

Objective 2a: Assessing liquidity

2.42 The term 'liquidity' may be understood slightly differently by different persons. It can be understood as how easily an asset can be exchanged for cash[24] (Objective 2a.1) or the amount of cash or liquid assets a company has easily available[25] (which can be used to meet its financial obligations) (Objective 2a.2). Under the latter, liquidity is thus the ease with which an entity can meet its financial obligations with the available liquid assets and be able to pay off debts as they come due[26]. However, even under the second understanding of the term (Objective 2a.2), there are slightly different interpretations. IFRS 7 *Financial Instruments: Disclosure*, defines liquidity risk as risk that an entity will encounter difficulty in meeting its obligations associated with financial liabilities that are settled by delivering cash or another financial asset. The Basel Committee defines liquidity as the ability of a bank to fund increases in assets and meet obligations as they come due, without incurring unacceptable losses[27]. Both definitions refer to the ability of an entity to meet its obligations in the future. IFRS literature does not define solvency, so it is not possible to assess how the IASB considers liquidity versus solvency. In this DP, liquidity is considered to be the ability to meet obligations when they come due under a shorter time-horizon than when assessing solvency.

2.43 Liquidity is a function of cash flows and is appropriately evaluated using cash ratios from the statement of cash flows as traditional liquidity ratios do not reflect the cash available for an entity to meet its financial obligations.

2.44 Having relatively many liquid assets could benefit the entity's solvency and agility/adaptability. Indeed, even fundamentally sound business will find it extremely difficult to survive in the short-term without liquidity. However, liquid assets may produce a lower return than less liquid assets.

2.45 The statement of cash flows provides information of past changes in liquidity. The future liquidity is affected by the assets and liabilities held by an entity as well as its fixed commitments. Statement of cash flows over the period ended at the reporting date cannot therefore provide sufficient information, in isolation, on the liquidity position and exposure to liquidity risk. However, it can provide insight about how the entity's business model is conducive to generating cash[28].

[23] Jones and Ratnatunga (1997).

[24] See, for example, Oxford Learner's Dictionaries (https://www.oxfordlearnersdictionaries.com/definition/english/liquidity?q=liquidity – Accessed 23/02/2024).

[25] See, for example, Collins Cobuild Advanced Learner's English Dictionary.

[26] See Hayes (2024).

[27] Basel Committee for Banking Supervision 2008.

[28] EFRAG (2015).

2.46 Some academics[29] have compared financial ratios related to liquidity assessments (in the meaning of meeting short-term financial obligations) based solely on information in the statement of financial position and the statement of profit or loss with ratios considering also information from the statement of cash flows. For example, the ratio: current assets over current liabilities is comparable to the ratio: cash flows from operating activities over current liabilities. The academics consider that the cash flow statement ratios should be used hand in hand with the traditional liquidity ratios since the cash flow ratios provide additional information and better insights into the liquidity position of a particular company. The major benefit of cash flow ratios is that these consider the resources the company has generated to meet its payment commitments over a period of time and not how much cash the company had available at a point in time.

Objective 2b: Assessing solvency

2.47 Like 'liquidity', 'solvency' may also be understood slightly differently. For example, for some it is related to (the market value of) assets over liabilities (when this ratio is less than one, the entity is insolvent) (Objective 2b.1) for others, it relates to the entity's ability to pay its debt[25] when due[30] (Objective 2b). In the latter case, evaluating solvency is assessing the risk that an entity will not be able to raise sufficiently cash before its debts must be paid[30]. Information that provides insight into the amounts, timings and uncertainty of an entity's future cash receipts and payments is useful in evaluating solvency[31]. As the statement of profit or loss does not address the timing of cash flows (unless it affects the 'value' of the consideration), the statement of profit or loss only provides limited information on this.

2.48 An entity can have a high amount of liquid assets but have issues with its solvency because the debt it will have to pay is even higher.

2.49 Although the assessment of solvency may seem to be particularly relevant for credit analysts, equity holders would also have an interest in the information as equity investors are likely to lose even more if the entity would become insolvent[30].

2.50 Although there has been academic evidence that cash flows from operation-based ratios are incrementally useful for predicting bankruptcy beyond the information contained in accrual-based ratios[32], other results indicate that during periods of financial distress operating profit is a better predictor of future solvency than earning figures[33]. In addition, similar to the studies comparing financial ratios related to liquidity assessments mentioned in paragraph 2.45 above, ratios related to solvency have also been assessed with the same recommendations being put forward[29].

[29] See, for example, Billah et al. (2015).

[30] See, for example, Heat (1978).

[31] Heat & Rosenfield (1987).

[32] Casey and Bartzcak (1985). The study was based on 'calculated cash flows from operations' and not cash flows from operations as reported in the statement of cash flows. Also, the study found that cash flows from operation-based ratios were useful for predicting bankruptcy (1–5 years prior to the bankruptcy) but did not represent any incremental usefulness compared to accrual-based ratios.

[33] Allen & Cote (2005).

Objective 3: Assessing the agility/adaptability of the entity

2.51 An entity's ability to react to opportunities and threats is improved if its actions can be done without having to raise financing. If an entity is not able to make investments (expected to be profitable), it can affect its long-term profitability[30].

2.52 When considering requiring detailed information on an entity's current operating cash flows, the FASB[34] thus noted that 'the greater the amount of future net cash inflows from operations, the greater the ability of the enterprise to withstand adverse changes in operating conditions'.

2.53 Information on the cash flows available after debt is being serviced could therefore be useful for the assessment of an entity's agility/adaptability.

2.54 However, when EFRAG discussed the usage of the statement of cash flows with users of financial statements, the objective of assessing an entity's agility/adaptability was seldom mentioned, and when it was mentioned, it was in relation to assessing whether additional finance would be needed for the entity to grow.

2.55 On the other hand, academic literature[35], notes that for debt analysts and creditors, information on liquidity and financial flexibility of an entity, especially in times of difficult access to the credit and bond markets, is important for credit decisions. Although these analyses may be based on current freely available funds and expected future changes in these, debt analysts and rating agencies require information for forward-looking analyses which is only partially provided in annual reports. This includes information on the accessibility and structure of liquid funds, the quality of unused committed credit lines, the time structure of future liquidity outflows, contingent liabilities and a breakdown of current financial liabilities by type of debt instrument.

2.56 The Australian study mentioned above[36], found that the statement of cash flows provided useful information for lenders for evaluating the ability to fund changes in the scope and nature of operations and the ability to obtain external finance. For investors, the study found that the statement of cash flows was considered to provide useful information for the entity's capacity to adapt to changing conditions.

2.57 Academic research indicates that entities with positive changes in available cash liquidity are more likely to make investments[37].

Objective 4: Assessing the ability of the entity to generate cash and cash equivalents

2.58 The assessment of the entity's ability to generate cash and cash equivalents is an important part of the information needed to assess the amount, timing and uncertainty of future net cash inflows.

2.59 It follows from paragraph 1.20 of the Conceptual Framework that

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[34] Referred in Casey & Bartczak (1985).

[35] Gebhardt & Mansch (2012).

[36] Jones and Ratnatunga (1997).

[37] See, for example, Beatty et al. (1997) and Lewellen & Lewellen (2016) for studies on US entities.

[i]nformation about a reporting entity's cash flows during a period also helps users to assess the entity's ability to generate future net cash inflows.

2.60 Following a statement in the FASB's Statement of Financial Accounting Concepts No. 1 (from November 1978) that information about earnings and its components is generally more predictive of future cash flows than current cash flows, academic literature has examined whether 'accrual accounting', as reflected in the statement of financial performance seems more useful for predicting future cash flows than past cash flows[38]. Academic literature generally indicates that cash flows is useful in predicting an entity's future cash flows and, although it may[39] or may not[40] on a stand-alone basis be better than the statement of performance, then it can provide additional information to the information included in the statement of financial position and the statement of financial performance[41]. Academic studies also show that information in the statement of cash flows is more useful for this objective than the cash flow information, users of financial statements would be able to derive themselves from the statement of financial position and the statement of financial performance. In addition, there have been some indications that cash flow components related to core operating cash flows (such as sales, cost of goods sold and general and administration expenses) are more predictive for future cash flows than non-core operating cash flows[42].

2.61 A number of academic studies have investigated the association of accounting figures with the market value of an entity and how well these figures are at explaining the market value (or changes in this). If information increases in the explanatory power for market values (or changes in this), it is assessed that the information is useful to investors. Based on this, some studies thus conclude that the statement of cash flows provide useful information[43].

2.62 Independently on how useful the statement of cash flows is for assessing the ability of the entity to generate cash and cash equivalents, it could be argued to be useful for checking whether previous estimates on this were correct.

2.63 Input collected by EFRAG confirms that information included in the statement of cash flows is actually used when valuing entities based on, for example, free cash flow to equity (for estimating equity value) or free cash flow to the firm (for estimating enterprise value).

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[38] See, for example, Finger (1994). This study finds that cash flow from operations is better at predicting cash flow from operations in the short term while for longer horizons, cash flows and earnings are approximately equivalent.

[39] See, for example, Nallareddy et al. (2020). This study finds that operating cash flows (using data from the statement of cash flows) outperforms income before extraordinary items and discontinued operations to predict future operating cash flows. Other studies include: Al-Debi'e (2011), Arnold et al. (1991), Dawar (2015), Farshadfar et al. (2008) and Habib (2010).

[40] See, for example, Dechow et al. (1998). This study finds earnings to be a better forecast of future cash flows than current cash flows. More recent studies include Ball & Nikolaev (2020); Jordan et al. (2007) (using share price as a proxy for future cash flows), Subramanyam & Venkatachalam (2007) (examining relation to post intrinsic value of equity) and Ebaid (2011),

[41] See, for example, Barth et al. (2001). This study finds that disaggregating earnings into cash flow and the major components of accruals significantly enhances earnings' predictive ability. Other studies include: Ahmes et al. (2006) and Habib (2008) (relation with security return).

[42] See, for example, Cheng & Hollie (2008).

[43] See, for example, Akbar et al. (2011) and Mostafa & Dixon (2013) for UK data.

2.64 The information included in the statement of cash flows can thus be used to analyse a company's underlying operating cash flows and free cash flow generation[44].

2.65 As noted by Gebhardt & Mansch (2012) and confirmed by input collected by EFRAG, equity analysts often use their own methods to determine and estimate cash flows, which include reconstructing the statement of cash flows. Alternative approaches used[45] include discounting expected future dividends and estimating enterprise value based on changes in net debt[46]. Information from the statement of cash flows can, together with information about movements in debt, be used to reconcile changes in net debt (from opening to closing balance) [47].

2.66 Although users try to estimate future cash flows, they may rely more on information in the statement of profit or loss and changes in assets and liabilities than from the figures reported in the statement of cash flows. In these cases, however, the input collected by EFRAG, indicates that often capital expenditures from the statement of cash flows is used for these estimates. Even when future cash flow projections are mainly based on figures from the statement of profit or loss, such as operating profit, the information included in the statement of cash flows on capital expenditures is often included (subtracted) after depreciations and amortisation expenses have been added back. In addition, information on capital expenditures is compared with amortisation and depreciation cost included in the statement of profit or loss to assess growth (potentials) of the entity. This comparison could thus indicate whether the entity is investing more (or less) than the recognised assets it is consuming.

2.67 Gebhardt & Mansch (2012) note that even though equity analysts do not base their estimations of future cash flows on the statement of cash flows, it is used to assess how good previous estimates of future cash flows were. The information included in the statement of cash flows, together with information about movements in debt, can thus be used to improve confidence in forecasting a company's future cash flows.

2.68 In addition, the information from the statement of cash flows is used to gain future insight in the entity when estimating future cash flows. As mentioned in paragraph 2.31, the statement of cash flows is thus used to assess the sustainable power of earnings. Input collected by EFRAG indicates that this information is also used by some when estimating future cash flows.

2.69 As further explained below in paragraph 2.87, the statement of cash flows can be used to assess how dividends are 'financed'. This information is also used by equity analysts who consider the dividend coverage ratio[48] showing the percentage of dividends payments that are backed by a good operating cash flow development[45]. The payout ratio is often used to determine the sustainability of dividends[49]. Low values are used to call into question future dividend payments of the same amount[45].

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44 Anderson (2023).

45 Gebhardt & Mansch (2012).

46 Input collected by EFRAG.

47 Anderson (2023).

48 Cash flows from operating activities / dividend payment.

49 Arnold et al. (2018).

2.70 To assess the ability of generating cash, a cash conversion rate is also sometimes calculated and presented as an alternative performance measure. This rate is, for example[50], calculated as the ratio of adjusted free cash flows (cash flows before acquisitions and dividends; before interest, tax and special items) to EBIT before special items.

2.71 Information on capital expenditures in the statement of cash flows is also used to assess whether the entity is investing sufficiently for the expected growth rate to be realistic. Similarly, the statement of cash flows is used to assess whether the entity can be expected to run into liquidity issues in the future, and thus indicate whether costs of additional finance should be included in the future cash flow estimations.

2.72 It has been noted that information of the entity's ability to generate cash from operations has become more important in Europe for users to estimate future cash flows following the decision of many entities to no longer preparing market outlooks for investors.

2.73 The Australian study mentioned above[51], found that the statement of cash flows was considered to provide useful information for lenders and investors for predicting future cash flows and monitoring fixed assets.

Objective 5 Assessing the effects of different accrual accounting practices

2.74 As the reporting of cash flows in principle[52] does not depend on accrual accounting practices, the cash flow statement of different entities could be used to compare the financial performance of entities applying different accounting practices (for the statement of profit or loss and the statement of financial position).

2.75 Although IAS 7 does not mention it directly, it seems implicit that the statement of cash flows can also be used to identify earnings management. This can be done by assessing whether changes in accruals seem abnormal.

2.76 When the cash flows from operating activities are presented using the direct method, the differences between, for example, revenue from customers and cash received from customers can be compared. When the indirect method is used changes in, for example, account receivables can be assessed.

2.77 The ability to compare financial statements prepared under different accrual accounting practices was not a point of focus by the users of financial statements from which EFRAG has received input. However, as it was mentioned in relation to Objective 1, the statement of cash flows is used to assess whether accruals are increasing. There can be many reasons for increasing accruals, but one reason could be that earnings management is carried out, and users have mentioned this as something the statement of cash flows can help identify[53].

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[50]Fresenius SE & Co. KGaA 2023 Annual Report page 69.

[51]Jones and Ratnatunga (1997).

[52] Following the IFRIC 2008 Agenda Decision to recommend to the IASB that IAS 7 should make explicit that only an expenditure that result in a recognised asset can be classified as a cash flow from investing activity, accrual accounting practices could have an impact on how cash flows are classified.

[53] Cooper & Jullens (2024).

2.78 The Australian study mentioned above[51], found that the statement of cash flows was considered to provide useful information for lenders and investors for comparing the performance of an entity with the performance of other entities.

Objective 6 Assessing management's stewardship

2.79 As stated in the Bulletin *Getting a Better Framework – Accountability and the objective of financial reporting* (EFRAG et al. 2013):

> [o]ne of the main arguments for providing information on accountability [which is used as a synonym for stewardship] is that it enables investors to oversee management behaviour. Although management are appointed by the shareholders, the interests of management and shareholders may diverge. For example, management may have an incentive to undertake risky investments where their entitlement to bonus payments is linked to profits but they do not share in any losses. Or management may prefer to avoid the work that would be required by restructuring the business. Financial statements that fulfil an accountability objective can assist shareholders in detecting where the business is not being managed in accordance with their objectives.

2.80 The statement of cash flows can be used to assess the management's:

a) general performance (Objective 6a); and

b) cash management (Objective 6b).

2.81 The statement of cash flows can be used for the general assessment of the performance of the management (Objective 6a) and specifically for the cash management (Objective 6b).

2.82 For the general performance assessment, cash flows from operating activities can be essential. The amount of cash flows from operating activities exerts a strong influence over corporate financing and investment decisions. Entities must rely on cash flows from operating activities to repay debt, pay dividends, fund operations, and finance investments (especially when external funds are costly)[54].

2.83 There are several aspects of stewardship:

a) responsibility of entrusted resources;

b) whether a reasonable return from entrusted resources is generated; and

c) which risks are undertaken to generate return on investment.

[54] Nwaeze et al. (2006).

2.84 The statement of profit or loss and the statement of financial position provide information for the assessment of the management's responsibility of entrusted resources. The statement of cash flows can, however, provide additional information. In the most extreme cases, the statement of cash flows can thus help in identifying whether the information presented in the statement of profit or loss and statement of financial position can be trusted. This can be done, for example, by assessing accruals (see Objective 1b). Similar to how the statement of cash flows can be used to compare the performance of an entity with its peers when assessing the amount, timing and uncertainty of future net cash inflows (Objective 5), the statement of cash flows can be used to assess the managements in a manner that is not affected by the use of particular accounting treatments. In this regard, the statement of cash flows can also be used to identify earnings management and fraud. The value relevance of the statement of cash flows for stewardship assessments is also evidenced by the use of cash flow measures when determining management's remuneration[55].

2.85 The statement of cash flows can also be used to assess whether a reasonable return from entrusted resources is generated. Therefore, it can be used to assess whether the entity is able to generate as much cash from operating activities as its peers.

2.86 For the assessment of risk, information about the entity's agility (Objective 3) and its investments (CapEx) is, among other things, useful.

2.87 For the cash management, the statement of cash flows can provide information on whether there are significant fluctuations in the amount of cash and cash equivalents; whether the entity 'suddenly' has to take up loans to finance acquisitions/growth; whether the entity is paying dividends despite cash deficits in operating activities and/or financing dividends through long-term loans. The statement of cash flows can also tell whether the management 'keeps' control of generated cash by investing this or transfers the control by paying dividends to its shareholders.

2.88 Although the deduced objectives have been divided between objectives related to the assessment of the amount, timing and uncertainty of future net cash inflows and the assessment of management's stewardship, it has appeared from the above that information listed for objectives 1–5 can also be useful for the assessment of management stewardship. Similarly, as stated in paragraph 1.22 of the Conceptual Framework, information about the entity's stewardship can be useful for assessing the entity's prospects for future net cash inflows.

2.89 Input collected by EFRAG indicates that the statement of cash flows is used by some to assess both the general performance of the management (Objective 6a) and its cash management (Objective 6b).

[55] Nwaeze et al. (2006) and Natarajan (1996).

2.90 In relation to the general performance of the management, the input collected by EFRAG reflect that the statement of cash flows is both used for an overall assessment of the management and for specific assessments. It is thus used overall to assess what the management has accomplished in terms of the plans and objectives set and specifically for the assessments of whether investments have paid off and how the cash flows from operating activities have been used. Information on capital expenditures is thus used, together with information included in the statement of profit or loss, to assess whether past capital expenditures have paid off. On the usage of cash flows from operating activities, it was noted that management has the discretion of using the cash flow from operating activities to either undertake reinvestment decisions or pay dividend. Therefore, the decision of management to use the cash flow from operating activities in paying for dividends or reinvestment also helps understand management stewardship.

2.91 In relation to the management's cash management, the statement of cash flows is used to assess whether the entity has the money it is spending.

2.92 The Australian study mentioned above[51], found that the statement of cash flows provided useful information for investors and lenders for evaluating managerial performance.

CHAPTER 3: ISSUES FOR NON-FINANCIAL ENTITIES

This chapter lists the issues for non-financial entities with the statement of cash flows prepared in accordance with IAS 7 that have been brought to the attention of EFRAG. The list includes issues brought to the attention of EFRAG which means that EFRAG does not necessarily agree with all the issues listed. For the issues listed, it has been assessed to which of the objectives listed in Chapter 2, the issues relate; the qualitative characteristics of useful financial information that are affected; and which of the objectives listed in Chapter 2 that could be aversively affected by solving the issue. The issues are categorised based on whether they are related to: the definitions of 'cash' and 'cash equivalents'; cash flows of an agent; non-cash transactions; classification of cash flows; disclosure requirements; aggregation of information; definitions of measures; cohesiveness with other primary financial statements; and presentation of cash flows from operating activities (the direct versus the indirect method).

3.1 IAS 7 is an old Standard and substantial modifications have been limited since it was first issued in 1992. Some argue that the statement of cash flows in its current form has not kept pace with changes in financial reporting practices, evolving business environments and non-traditional transactions. Therefore, the Standard does not provide clear requirements for certain transactions. In addition, IAS 7 includes various options, and some argue that it is not particularly prescriptive in relation to presentation.

3.2 This chapter deals with the issues identified by some related to how the statement of cash flows is currently prepared under IAS 7. The list is a 'gross list' meaning that it includes issues brought forward. However, EFRAG has not made an assessment on whether it would agree with all the items listed. The identified issues are classified into the following categories:

a) the definitions of 'cash' and 'cash equivalents'

b) cash flows of an agent

c) non-cash transactions

d) classification of cash flows

e) disclosure requirements

f) aggregation of information

g) definitions of measures

h) cohesiveness with other primary financial statements

i) presentation of cash flows from operating activities

3.3 For many of the listed categories there are issues with: divergence in practice/different interpretations of the requirements; the understandability of the information; and the relevance of the information the current requirements result in.

3.4 Divergence in practice affects comparability of information between entities. This directly affects the relevance of the statement of cash flows for assessing the effects of different accrual accounting practices (Objective 5) and the comparability of the information between different entities of the other objectives. The different practices/the different interpretations would also generally result in outcomes that would result in information with varying relevance for a particular objective. It is, however, outside the scope of this DP to assess and compare the relevance of the outcomes of these different practices/interpretations.

3.5 For the issues where some consider that the current requirements do not result in the most relevant information, this DP provides an assessment of which of the deduced objectives that are affected. It also notes which objectives that potentially could be adversely affected by amending IAS 7 in a manner that would address the issue. Table 1 below provides an overview of these. The table, for example, shows that the limitations currently in IAS 7 on what to consider as cash and cash equivalents can make the statement of cash flows less relevant for assessing solvency (Objective 2b). However, considering additional items as cash or cash equivalents could reduce the relevance of the statement for assessing liquidity (Objective 2a). The table thus highlights areas where the various deducted objectives of the statement of cash flows may be competing, and it has to be decided which objective(s) are the most important.

Table 1 – Identified issues where some consider that the current requirements of IAS 7 may not result in the most relevant information.

Potential issues	Particular relevant for	Qualitative characteristics mainly affected {potentially adversely affected by a solution}
The definitions of 'cash' and 'cash equivalents'		
The definitions of 'cash' and 'cash equivalents' is to some extent open for interpretation.	All objectives	Comparability
	Objective 1a	{Relevance}
Requirements on which items should be considered cash equivalents are too restrictive (could consider items that could be converted into cash in a six- months period).	Objectives: 2b; 6b	Relevance
	Objective: 2a	{Relevance}
Requirements on which items should be considered cash equivalents are not sufficiently restrictive. Only cash that is readily available should be included.	Objective: 2a	Relevance
	Objectives: 2b; 6b	{Relevance}
Cash flows of an agent		
Cash flows of a party acting as an agent are not (always) presented in the statement of cash flows.	All objectives	Relevance
Non-cash transactions		
Certain non-cash transactions (e.g., payments in own shares or sales in crypto currencies) are not included in the statement of cash flows.	Objectives: 1a; 4; 5; 6a	Relevance {Faithful representation)
	Objectives: 1a; 1b.1; 2; 3; 4; 5; 6b	{Relevance} {Faithful representation)

Potential issues	Particular relevant for	Qualitative characteristics mainly affected {potentially adversely affected by a solution}
Certain non-cash transactions are not included in the statement of cash flows (e.g., payments that do not occur in a multiple-component transaction but would have occurred if the various components would have been carried out by different parties).	All objectives	Relevance {Faithful representation}
Classification of cash flows		
Certain non-cash transactions related to multiple-component transactions are not included in the statement of cash flows.	All objectives	Relevance {Faithful representation}
The classification in the statement of cash flows depends on whether the expenditure would be capitalised in the statement of financial position.	Objectives: 5 (1a; 4; 6a)	Relevance
	Objectives: (1a; 1b.1; 4; 6a)	{Relevance}
Related inflows and outflows are classified differently.	Objectives: 1b.2; 4; 6a	Relevance
	Objectives: 2; 3; 4; 6b	{Relevance}
No distinction between operating and finance lease.	Objectives 1b.2; 4; 6a	Relevance
	Objectives: 2; 6b;	{Relevance}
Tax payments are classified as operating cash flows 'by default'.	Objectives: 1b.2; 4; 6a	Relevance
Tax payments are not presented separately, like in IFRS 18.	Objectives: 1b.2; 4; 6a	Relevance
Disclosure requirements		
No specific requirements to provide information on the preparation and classification choices made by the entity.	All objectives	Relevance; faithful representation
No specific requirements to provide information about intercompany cash flows.	Objective: 1a	Relevance
Requirements on information on restrictions do not take all restrictions into account (e.g. minority interests) and do not include requirements on information on the location of cash.	Objectives: 2; 3; 4;6b	Relevance; faithful representation
No specific requirements in IAS 7 on disclosures related to liquidity and ability to service debt (some additional information is encouraged).	Objectives: 2; 3; 4; 6b	Relevance

Potential issues	Particular relevant for	Qualitative characteristics mainly affected {potentially adversely affected by a solution}
No specific requirements on information on non-cash income.	Objectives: 1a; 1b.2; 4; 6a	Relevance
No requirements on information on non-recurring cash flows.	Objective: 1a; 1b.2; 4; 5; 6a	Relevance
No requirements on information on the impact of business combinations on the statement of cash flows.	Objectives: 1b.2; 4; 5; 6a	Relevance
Limited requirements on reconciliations.	All objectives	Understandability
Aggregation of information		
No specific requirements for disaggregation of information.	All objectives	Relevance; understandability, faithful representation
No distinction between expenditures used for maintenance and growth.	Objective: 4	Relevance; {faithful representation}
No distinction between dividends to controlling and non-controlling interests.	Objective: 4	Relevance

Objective 1: evaluate changes in net assets; **Objective 1a**: understand the business; **Objective 1b**: assessing accruals; **Objective 1b.1**: assess closeness to cash; **Objective 1b.2**: assess current performance; **Objective 2**: assess the financial structure; **Objective 2a:** assess an entity's liquidity; **Objective 2b:** assess an entity's solvency; **Objective 3**: assess agility; **Objective 4**: assess the ability to generate cash and cash equivalents; **Objective 5:** Assessing the effects of different accrual accounting practices; **Objective 6:** assess stewardship; **Objective 6a**: assess management's general performance; **Objective 6b:** assess management's cash management.

The definitions of 'cash' and 'cash equivalents'

3.6 The issues mentioned by some in relation to the definitions of 'cash' and 'cash equivalents' in IAS 7, are[56]:

a) The requirements on what should be considered cash and cash equivalents are interpreted differently and may accordingly not result in comparable information; and

b) The requirements on what should be considered cash and cash equivalents may not result in the most relevant information for all objectives of the statement of cash flows.

3.7 These two issues are further described below.

Different interpretations on what are cash and cash equivalents

3.8 According to Chapter 2, some of the objectives of the statement of cash flows are to:

a) assess an entity's liquidity (Objective 2a)

[56] Also, some respondents to the IASB's third agenda consultation supported the review of the definitions (IASB 2022).

b) assess an entity's solvency (Objective 2b)

c) assess an entity's agility (Objective 3)

d) assess the ability of the entity to generate cash and cash equivalents (Objective 4)

e) assessing the effects of different accrual accounting practices (Objective 5)

f) assess an entity's cash management practices (Objective 6b)

3.9 Particularly for objectives: 2a, 2b, 5 and 6b, it can be important what is considered cash and cash equivalents (for Objective 4, the importance depends on how the statement of cash flows is used). For example, the conclusion impacts liquidity ratios and could also impact compliance with regulatory requirements[57].

3.10 The definitions of cash and cash equivalents are therefore important for the statement of cash flows, particularly to ensure relevant and comparable information related to the objectives mentioned above.

3.11 Paragraph 6 of IAS 7 provides the definitions of cash and cash equivalents:

> **Cash** comprises cash on hand and demand deposits.
>
> **Cash equivalents** are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

3.12 Under the heading 'cash and cash equivalents', paragraph 7 of IAS 7 further states that:

> Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date.

3.13 There can be different interpretations on the definitions of cash and cash equivalents, which may cause diversity in practice on what can be classified as cash and cash equivalents[58].

3.14 As it appears from the definition, cash comprises cash at hand and demand deposits. Even though IAS 7 does not provide a definition of 'demand deposits', these are considered to be commonly understood in practice. Also, the amounts not classified as 'cash' because they do not qualify as 'demand deposits', may still qualify as 'cash equivalents'[59].

3.15 However, there are several issues with what is considered cash and cash equivalents which could affect the comparability between entities of the information provided for the objectives mentioned above. These include[60]:

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[57] Information collected at EFRAG round tables on the statement of cash flows

[58] EY International Financial Reporting Group. 2024.

[59] EY International Financial Reporting Group. 2024.

[60] In addition to the issued mentioned, the IFRS Interpretations Committee has also considered issues related to whether an asset is cash or cash equivalents. These include: whether a demand deposit is part of cash when the demand deposit is

a) What the meaning is of 'short-term maturity'. Here the main issue is whether the reference to 'three months' in paragraph 7 of IAS 7 should be strictly interpreted, or being considered as a benchmark/example[61]. This results in diversity in practice on how entities apply the notion of short-term maturity[62] [63]. Although some consider the requirements to be unclear, EFRAG has also heard the view that the requirements are sufficiently clear, but are not applied by preparers (and auditors)[64].

b) Whether digital currencies meet the definition of 'cash and cash equivalents'. Literature discusses three types of digital currencies: central bank digital currencies (CBDCs); fiat-backed stable coins and privately issued cryptocurrencies (e.g., Bitcoin)[65]. This section only deals CBDCs and fiat-backed stablecoins, as privately issued cryptocurrencies do (currently) not classify as cash according to the IFRIC agenda decision issued in 2019[66]. In contrast, some stable coins[67] and CBDC is considered by some to be 'cash'. CBDC is the digital form of a country's currency issued by a central bank[68] intended to act as an equivalent to cash[69]. However, there are arguments against classifying CBDC as cash, as there could be both positive and negative interest charges on CBDC. This causes diversity on how digital currencies are dealt with across jurisdictions[70].

c) How an entity and its auditors assess whether there is an insignificant risk of changes in value. As the default position seems to be that an item (e.g., an investment, held for the purpose of meeting short-term cash commitments, that can be withdrawn on demand with an early withdrawal penalty) is not cash or cash equivalent, some entities may put efforts into providing supporting evidence of the existence of only an insignificant risk of changes in value and that the investment is held for the purpose of meeting short-term cash commitments, while other entities may not find the challenges of gathering sufficient evidence to support that statement worthwhile[71], and hence choose to consider the item as non-cash.

subject to contractual restrictions on use agreed with a third party (IFRIC Update March 2022); whether investments can be classified as cash equivalents based on the remaining period to maturity (IFRIC Update May 2013); whether shares or units of money market funds that are redeemable at any time can be classified as cash equivalents (IFRIC Update July 2009); when short-term loans and credit facilities can be considered a component of cash and cash equivalents (IFRIC Update June 2018); whether cash in transit is cash (this discussion was reflected in Amendments to the Classification and Measurement of Financial Instruments (Amendments to IFRS 9 and IFRS 7), issued by the IASB in May 2024).

[61] Information collected at EFRAG round tables on the statement of cash flows and BDO (2022).

[62] Information collected at EFRAG round tables on the statement of cash flows.

[63] It has also been questioned (e.g., at roundtables held by EFRAG) whether the reference to the 'three months' means that transactions with a longer maturity are considered to be non-cash transactions, for example when the regular payment-terms are set to 4-5 months. In this regard, it should, however, be noted that only the definition of 'cash equivalents' includes the reference to 'three months'. The definition of cash does not.

[64] Information collected at EFRAG round tables on the statement of cash flows.

[65] Alsalmi et al. (2023).

[66] IFRIC (2019).

[67] Hampl & Gyönyörová (2021).

[68] EY International Financial Reporting Group (2024).

[69] Alsalmi et al. (2023).

[70] Information collected at EFRAG round tables on the statement of cash flows.

[71] Information collected at EFRAG round tables on the statement of cash flows.

d) Whether/when deposits by entities within a group treasury function to be classified as cash and cash equivalents[72]. This issue is only relevant for entity's separate financial statements. A related issue may be if an entity in its separate financial statements should include a statement of cash flows, if an entity does not hold any cash and cash equivalents, and all payments are made by the groups treasury function, resulting in only changes in inter-company balances[72].

3.16 The issues listed above could, in addition to affecting the comparability between entities of the information in the statement of cash flows, also result in difficulties for users in understanding what exactly is reflected in the statement of cash flows and accordingly the perceived faithful representation[73].

3.17 As a result of these issues, some suggest considering removing changes in cash equivalents from the statement of cash flows. They argue that it would be easier to clarify what is 'cash' than what is 'cash and cash equivalents'[74].

3.18 Against making a too specific definition of 'cash' and 'cash equivalents' some argue that it would make it more difficult for entities to reflect in the terms what they manage. A very prescriptive definition may thus make it difficult 'to reflect the business' in the statement of cash flows (Objective 1a).

Usefulness of the information resulting from the requirements on what should be considered cash and cash equivalents

3.19 Some are also questioning whether the current definitions of cash and cash equivalents result in the most useful information. However, some of the concerns expressed point in different directions.

a) Some consider the requirements to be too restrictive on what can be considered 'cash and cash equivalents'. For example, some do not find it useful that for example six months term deposits are not considered cash equivalents as these assets can be easily converted into cash and their exclusion from the statement does not align with the entity's liquidity management approach[75]. In other words, the current requirements do not result in the most useful information for assessing management's cash management (Objective 6b). Similarly, some credit rating agencies may consider a longer conversion period (of, for example, six months) when assessing credit ratings (Objective 2b).

b) Others consider that the requirements are not sufficiently restrictive. The requirements allow investments for which time is needed for cash conversion to be considered 'cash equivalents' and hence appear from the statement of cash flows. This seems to be the case even if the time needed is several months. Therefore, from a liquidity perspective they may not be readily available in reality[76]. In other words, the current requirements do not result in the most useful information for assessing liquidity (Objective 2a).

[72] BDO (2022).

[73] Cooper & Jullens (2024).

[74] Information collected at EFRAG round tables on the statement of cash flows.

[75] Information collected at EFRAG round tables on the statement of cash flows.

[76] Information collected at EFRAG round tables on the statement of cash flows.

Cash flows of an agent

3.20 There are differing views on how to present cash flows when an entity is directing another party to pay and/or receive cash on its part (i.e. situations where another party acts as an agent of the entity). This could happen in a multiple component transaction which, for example, could involve both the transfer of an asset and a financing agreement. A finance provide could thus act as an agent of a reporting entity in relation to the acquisition of a particular asset, for which it will provide the entity with a financing solution. There is no broader guidance on this included in IAS 7[77]. The question here is whether cash flows should be presented as if the entity itself had paid/received the cash flows or should only include the cash flows between it and the agent. For example, if an entity purchases an asset and finances the purchase by borrowing money from a bank, it may arrange for the money to be paid directly by the bank, instead of first receiving the money and then paying it to the vendor of the asset.

3.21 Not including all cash flows in multiple component transactions when the third party acts an agent for the entity could impede the relevance of the information in relation to all of the objectives.

3.22 Similarly, it is unclear whether VAT cash flows should be included in the statement of cash flows. Due to the absence of explicit guidance, entities may adopt different practices, potentially affecting the comparability of financial statements[78].

Non-cash transactions

3.23 All non-cash transactions are excluded from the statement of cash flows. Some consider this could affect:

a) comparability

b) the relevance of the information provided for some of the deduced objectives of the statement of cash flows.

Comparability

3.24 In this DP, non-cash transactions are considered to be:

a) Transactions that do not involve cash or cash equivalents. For example, the purchase of an asset by means of own shares, sales for which bitcoins are received or converting debt to equity.

b) Multiple components transactions that involve cash or cash equivalents, but which result in the cash flows to and from an entity being reduced compared to a situation where the various components had not been bundled. For example, acquiring an asset by assuming a directly related liability (including obtaining a right-of-use asset in exchange for a leases liability); and reverse factoring arrangements (which resembles cash transactions involving credit facilities)[79]. In some of these arrangements, a party

[77] EY (2024).

[78] Badenhorst & Ferreira (2016).

[79] Information collected at EFRAG round tables on the statement of cash flows.

acting as an agent for the reporting entity (see paragraphs 3.20–3.21 above) may be involved, but this may not always be the case.

3.25 Multiple component transactions may not only affect the cash flows of a transaction but could alternatively/also affect the classification of the cash flows (see below on categorisation issues).

3.26 Some argue that excluding all non-cash transactions from that statement of cash flows does not result in comparable information. For example, some argue that the purchase of an asset (or a business) in exchange for own shares has the same economical substance as first selling own shares and then purchase an asset with the cash received. They accordingly argue that the two transactions should be presented similarly in the statement of cash flows. The same could apply to other non-cash transactions, including sales in exchange for cryptocurrencies; the acquisition of assets either by assuming directly related liabilities or by means of a lease; obtaining a building or investment asset by receiving a gift; obtaining a beneficial interest as consideration for transferring financial assets (excluding cash); and the conversion of debt to equity[80].

Relevance of the information provided for some of the deduced objectives of the statement of cash flows

3.27 In addition to not resulting in comparable information, some argue that excluding all non-cash transactions from the statement of cash flows does not result in the most relevant information. Some financial statements users thus disagree that the statement of cash flows should focus only on cash, as in practice non-cash transactions[81] are considered in their analyses[82].

3.28 Not including certain non-cash transactions such as the acquisition of an asset by means of own shares may impede the relevance of the statement of cash flows for: understanding the entity's business (Objective 1a); assessing the management's general performance (Objective 6a). However, including non-cash transactions may impede: assessing the cash management (Objective 6b); assessing the quality of earnings (Objective 1b.1); assessing the entity's financial structure (Objective 2); and assessing the entity's ability to affect the amounts and timing of cash flows (Objective 3). It could also be confusing for users and it should also be considered that there are already (other types of) disclosures informing about non-cash transactions.

[80] IAS 7.44 and ACS 230-10-50-4.

[81] Information collected at EFRAG round tables on the statement of cash flows.

[82] Information collected at EFRAG round tables on the statement of cash flows.

3.29 For the purpose of assessing the ability of the entity to generate cash and cash equivalents (Objective 4) and comparing entities (Objective 5), including non-cash transactions, such as transactions settled by the transfer of own shares, might have both benefits and disadvantages for the relevance of the information. As previously mentioned, some of those who use the statement of cash flows when assessing the ability of the entity to generate cash and cash equivalents, only use the information on CapEx. For these users, it could be argued to be beneficial if this figure would include, for example, acquisition made by transferring own shares. On the other hand, if the entity's possibilities of paying dividends is in focus, including revenue received in non-cash (and cash equivalent items) may reduce the usefulness of the statement. For the purpose of comparing entities, it could, on the one hand be beneficial to present in a similar manner, transactions that have the same economic effect (see the example in paragraph 3.26 above). On the other hand, when non-cash items are received or used for payment, valuation of these items may be needed, and this could impede the independence of measurement requirements/guidance of the statement of cash flows.

3.30 Reflecting non-cash transactions in a statement of cash flows could also be argued not to be a faithful representation.

Classification of cash flows

3.31 As per paragraph 10 of IAS 7, an entity needs to classify cash flows by operating, investing, and financing activities. The classification of cash flows is a central element of the statement of cash flows. Munter (2023) thus notes that the staff of the Office of the Chief Accountant of the U.S. SEC has not found analyses persuasive concluding that an error in the statement of cash flows is not material because it is an error in classification only. Munter (2023) notes that classification itself is the foundation of the statement of cash flows. Accurately classifying cash flows as operating, investing, or financing activities is paramount understanding the nature of the issuer's activities that generated and used cash during the reporting period.

3.32 Some consider that the current requirements IAS 7 on classification could affect:

a) comparability of the information

b) the relevance of the information provided for some of the deduced objectives of the statement of cash flows.

Comparability of the information

3.33 Even though IFRS 18 has made some minor amendments to IAS 7, and in particular relevant to this chapter, the presentation of interest and dividends paid and received[83] addressing some classification issues, there is still diversity in practice on how to classify other types of cash flows.

[83] PwC Viewpoint (2024).

3.34 IAS 7 provides broad definitions of the categories and a non-exhaustive list of examples, which some consider result in misclassification errors and diversity on how similar transactions are presented across entities[84]. There may be two reasons to why cash flows are classified differently between entities: 1) options included in IAS 7 on classification 2) IAS 7 does not provide specific guidance on how to classify some cash flows.

Options included in IAS 7

3.35 The issuance of IFRS 18 in April 2024 resulted in some of the explicit options provided in IAS 7 on the classification of payments or cash receipts form interest and dividends being removed. However, for entities that invest in assets or provide financing to customers as a main business activity, there is still some flexibility in relation to the categorisation of interest and dividend received and interest paid.

Cash flows for which there is no specific guidance on categorisation

3.36 The cash flows for which diversity currently exists in practice, as there is no specific guidance on how to classify these cash flows, include (but are not limited to):

a) payments related to unfunded defined benefit pension schemes[85]

b) cash received from factoring of trade receivables[86]

c) cash received as compensation for an insured loss

d) cash received from a government grant

e) cash payments related to the purchase of an asset on deferred payment terms from the supplier[86]

f) cash received in a sale and lease back arrangement where the transaction qualifies as a sale under IFRS 15

g) cash received and cash payments related to derivatives that are 'collateralised-to market'

h) cash payments related to supply-chain financing arrangements and reverse factoring arrangements[87] [88]

i) cash payment to meet a rehabilitation obligation

j) payment of deferred consideration in a business combination

k) payment of variable consideration in a business combination[91]

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[84] EY International Financial Reporting Group (2024).

[85] Information collected at EFRAG round tables on the statement of cash flows.

[86] EY (2024).

[87] Information collected at EFRAG round tables on the statement of cash flows.

[88] EY (2024).

l) payment of variable consideration for an asset outside of a business combination[89]

m) payment during the construction phase of a service concession arrangement[90]

n) cash flows related to obtaining a contract, that are capitalised in accordance with IFRS 15 *Revenue from Contracts with Customers*[91]

o) payments of at the inception of a lease (if not all the amounts under a lease contract are due at inception of the lease)[91]

p) cash flows related to the acquisition and sale of securities and loans held for dealing or trading (whether the requirements in IFRS 9 should direct when an instrument is held for trading)[92]

q) cash flows from the early settlement or 'close out' of certain derivatives, such as interest rate swaps[92]

r) cash flows on derivatives that are economic hedges but not designated as hedging instruments in accordance with IFRS 9[93].

3.37 Some point to the definition of operating activities in IAS 7 as a cause of the diversity in practice[94]. Operating activities are defined as:

> the principal revenue-producing activities of the entity and other activities that are not investing or financing activities. (IAS 7.6)

3.38 The term 'operating cash flows' can thus be confusing as it may not directly relate to operating income. New, innovative transactions are difficult to classify within cash flow statements and often default to the operating category. Some thus consider that clear classification requirements for new types of transactions are needed.[95]

3.39 However, different views exist on whether operating activities should be defined directly or left as a residual category. If defined directly, it could result in excluding some classes of expenditures which are intended to enhance operating capabilities but not capitalised as assets.[96]

3.40 Input collected by EFRAG has suggested that to be most relevant for users of financial statements, the classification should be based on whether the cash flow is related to the impact of operations or is relevant for understanding leverage[97].

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[89] EY (2024).

[90] Deloitte (2024).

[91] BDO (2022).

[92] BDO (2022).

[93] Deloitte (2024).

[94] Information collected at EFRAG round tables on the statement of cash flows.

[95] Information collected at EFRAG round tables on the statement of cash flows.

[96] Information collected at EFRAG round tables on the statement of cash flows.

[97] Information collected at EFRAG round tables on the statement of cash flows.

Relevance of the information

3.41 Some consider that the current guidance on how to classify cash flows as well as the classifications that may in practice sometimes be applied due to the lack of clear requirements may not result in the most useful information.

Multiple component transactions

3.42 One of the issues is here related to the multiple component transactions described in paragraph 3.24b) above.

3.43 The fact that non-cash transactions are not reflected in the statement of cash flows can, for example, result in the entity having no cash outflows related to the payment of suppliers if there is a supplier finance arrangement that result in extended credit terms for the entity (the purchaser). In this case, depending on the circumstances, all payments related to goods and services acquired by an entity could be presented as financing cash flows. Similarly, if an entity, for example, is factoring its receivables and the customers are required to pay directly to the financial institutions, but the arrangement does not result in the derecognition of the original trade receivable, it could be, depending on facts and circumstances as well as the interpretation of the current requirements, that cash flows from operating activities would not include cash flows related to the sale of the entity's goods and services. Some do not consider this results in comparable and the most relevant information.

3.44 The solution to the issues above, would, however, likely not be to require the cash flows mentioned above as operating cash flows as this would not reflect the financing that is also taking place.

3.45 As cash flows from operating activities is important for most of the objectives of the statement of cash flows, the relevance of the statement of cash flows for these objectives may accordingly be affected. On the other hand, reflecting non-cash transactions in the statement of cash flows could be argued to reduce the faithful representation of the statement.

Only classifying expenditures that are capitalised as cash flows from investing activities

3.46 According to IAS 7.16 (which was added in 2008), only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities.

3.47 Some do not consider this to result in the most relevant information. One concern expressed it that not presenting investments in unrecognised assets may result in operating cash flows being underestimated[98] [99]. As noted above, relevant information on cash flows from operating activities is relevant for most of the objectives of the statement of cash flows identified in this DP. In addition, as CapEx information from the statement of cash flows is also an important information for the assessment of the ability of the entity to generate cash and cash equivalents. Some could therefore argue that the requirement may not result in the most relevant information for assessing the ability to generate cash and cash equivalents. Finally, as the classification would then depend on the accounting treatment of certain expenses (e.g. research and development expenditures) the relevance of the statement of cash flows for comparing entities (Objective 5) is reduced.

3.48 On the other hand, not linking the classification to the accounting treatment in the statement of financial position could have resulted in divergence in practice on which cash flows would have been presented under investment activities (comparability would be affected). Different 'categorisation' in the statement of cash flows and the statement of financial position could also reduce the understandability of the financial statements/create confusion.

Related inflows and outflows are classified differently

3.49 Another point raised by some as not resulting in the most relevant information is that some cash inflows can be classified as resulting from operating activities, while the related outflows are presented under another activity. This could, for example, happen in relation to supplier finance arrangements (see above) and cash received from a government grant. Some do not consider this to result in the most relevant information about the cash flows from operating activities, which could affect the relevance of the information in relation to, for example, assessing the entity's current performance (e.g., in case of reverse factoring arrangements it can seem that an entity's operating activity is generating more cash and cash equivalents, than is the case); assessing the entity's ability to generate cash and cash equivalents; and assessing general performance. However, requiring related inflows and outflows to be included within the same category could reduce the relevance of the information for assessing the entity's financial structure (if it would mean that certain cash flows would not be reflected in the category best reflecting the activity to which they relate); assessing the entity's ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities; assessing the ability of the entity to generate cash and cash equivalents; and assessing the management's cash management.

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[98] Barker & Penman (2020).

[99] The European Sustainability Reporting Standards (ESRS) do also consider as capital expenditures only those expenditures resulting in additions to assets (see Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 par. 1.1.2 of Annex I). Any changes to how capital expenditures would be considered in the statement of cash flows could accordingly result in connectivity issues.

Distinction between operating and finance lease

3.50 Some users of financial statements prefer the previous distinction in IFRS Accounting Standards between operating and finance lease. They note that it is confusing that cash flows that were previously related to operating leases and presented as cash flows from operating activities are now presented under financing activities[100]. They consider that for a more relevant classification, the difference between lease and in-substance purchase should be better clarified by the IASB. The classification also impacts the entity's KPIs and the presentation of related outflows in the cash flow statement. The distinction between cash flows from operating activities and investing activities is, among other things, important when assessing the performance of an entity. The relevance of the information included in the statement of cash flows could thus, for example, be affected for the objectives of assessing the current performance of the entity; assessing the ability of the entity to generate cash and cash equivalents and assessing management's general performance. On the other hand, re-introducing a distinction between finance and operating lease could reduce the relevance of the statement of cash flows for assessing an entity's financial structure and assessing management's cash management.

Classification of tax payments

3.51 In relation to the classification of tax payments two issues have been raised to EFRAG as part of its proactive project on the statement of cash flows:

a) Firstly, that the 'default' classification of tax payments as cash flows from operating activities results in taxes related to, for example, financing is presented as cash flows related to operating activities. The view has thus been expressed that the tax rate can differ between the different categories and there is thus a need to provide information on the different tax attributes across the financing cash flows and the operating cash flows[101]. On the other hand the view has also been expressed that specific information on taxes should be provided in the tax notes and not in the statement of cash flows.

b) Secondly, classifying even taxes related to operating activities as cash flows from operating activities creates an inconsistency with IFRS 18 since income taxes are not considered part of operating profit. Therefore, some suggest that taxes should be a separate category to allow comparison with the statement of profit or loss.

3.52 The classification of tax payments could affect the relevance of the information for assessing the current performance of an entity; assessing the ability of the entity to generate cash and cash equivalents; and assessment management's general performance.

Disclosure requirements

3.53 The disclosure requirements in IAS 7 are, when compared with other IFRS Accounting Standards, relatively limited. Input collected by EFRAG indicates that additional disclosure requirements on particularly the following issues are wanted by some:

[100] Information collected at EFRAG round tables on the statement of cash flows.

[101] Information collected at EFRAG round tables on the statement of cash flows.

a) Preparation and classification choices made by the entity[102]. Information on classification choices relates to cash flows for which the classification is not obvious, for example, payments related to defined benefit pension plans[103] and other of the classifications listed in paragraph 3.36. Also, users have observed that changes in foreign exchange rates are treated inconsistently in the cash flow statement and it is also often unclear how foreign exchange rate changes has been dealt with in the reconciliation of operating cash flow and changes in working capital.[104]

b) Intercompany cash flows. Some preparers, for example, experience, and some users confirmed[105], that more information on 'upstreaming of cash flows' is wanted. For example, in a case where significant investments are made without additional cash flows from financing activities. Some users want to know which part of a group is 'financing' this investment[106]. Also, users want to know where in a group the cash is held, as cash held by one company in a group may not be available for another entity in the group[107] (see below on restrictions on cash). Information on intercompany cash flows could enhance the relevance of the information for understanding the entity's business.

c) Restrictions on cash. This information is used for assessing cash availability[108] which is necessary for estimating future dividends, debt service and CapEx abilities. As cash within a group may not be (readily) available for another entity within a group, some users request additional information on an entity's ability to service debt and invest[109]. IAS 7 already includes requirements to disclose information significant cash and cash equivalent balances held by the entity that are not available for use by the group. However, users have identified two issues with the current requirements. Firstly, that they seem to be interpreted/applied differently[110]. Some users thus note that they often receive insufficient information on the restrictions. For example, sufficient information is not always received on entities with subsidiaries in other countries in which local regulators have restricted the amount of cash that can be transferred[111]. Secondly, users of the financial statements of a parent entity are also interested in knowing about cash that is/is not available to the parent entity. If cash is located in a subsidiary that is not fully controlled, all the cash of that subsidiary cannot be transferred to other entities within the group my means of dividend payments as the minority interests of the subsidiary also should have their share of the dividends and in addition there may be various fees and taxes that would have to be paid when transferring cash (which would reduce the amount of cash that can be transferred). If the cash of a group is 'located' at the entities that will have to service debt or should make investments, there may not be an issue, but if there are restrictions on how cash

[102] Information collected at EFRAG round tables on the statement of cash flows.

[103] Information collected at EFRAG round tables on the statement of cash flows.

[104] Information collected at EFRAG round tables on the statement of cash flows.

[105] Information collected at EFRAG round tables on the statement of cash flows.

[106] Information collected at EFRAG round tables on the statement of cash flows.

[107] Information collected at EFRAG round tables on the statement of cash flows.

[108] Information collected at EFRAG round tables on the statement of cash flows.

[109] Information collected at EFRAG round tables on the statement of cash flows.

[110] Information collected at EFRAG round tables on the statement of cash flows.

[111] Information collected at EFRAG round tables on the statement of cash flows.

can be transferred, and the cash is not 'at the right places' problems can arise. Therefore, more disclosure is demanded on what cash is restricted and for what type of activities[112]. Information on the restrictions and location of cash and cash equivalents, could enhance the relevance of the information for assessing the entity's financial structure; assessing the entity's ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities; assessing the ability of the entity to generate cash and cash equivalents; and assessing management's cash management.

d) Liquidity and ability to service debt. Some do not consider the information provided in the statement of cash flows (together with the other information presented in the financial statements) to be sufficient to assess an entity's financial structure (Objective 2). Liquidity mismatches (particularly relevant for certain sectors) that may result in actual liquidity problems are not captured by the current financial statements.[113] It has also been noted that the information on interest payments does not inform whether payments are related to service debt. They suggest additional information on liquidity and collateral is needed.[114] In relation to liquidity, information on unused drawing rights would also be relevant. While, for example, information on liquidity mismatches would be relevant for understanding an entity's liquidity position, it could be argued that this type of information would better fall within IFRS 7 than IAS 7. Information on liquidity and the ability to service debt, could enhance the relevance of the information for assessing the entity's financial structure; assessing the entity's ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities; assessing the ability of the entity to generate cash and cash equivalents; and assessing management's cash management.

e) Information about non-cash income. Some users would like to know more about the non-cash income. It is noted that sometimes the management report includes more detail about this[115]. Although IAS 7 require disclosures of material non-cash transactions cases were found by the FRC that these disclosures were missing or could be improved[116]. As noted above, some consider that certain non-cash transactions should be reflected in the statement of cash flows. Information about non-cash income might enhance the information for understanding the entity's business; assessing current performance of the entity; assessing the ability of the entity to generate cash and cash equivalents; and assessing management's general performance.

f) Information about non-recurring cash flows. In order to assess the entity's ability to generate cash and cash equivalents (Objective 4) and being able to compare information with previous years, some users consider that information about 'one-off' or 'non-recurring' cash flows would be useful[117]. A 'one-off' effect for which information should be provided could thus be the introduction of a reverse factoring

[112] Information collected at EFRAG round tables on the statement of cash flows.

[113] Information collected at EFRAG round tables on the statement of cash flows.

[114] Information collected at EFRAG round tables on the statement of cash flows.

[115] Information collected at EFRAG round tables on the statement of cash flows.

[116] PwC (2022).

[117] Elisa 2023 annual report (page 23) presents 'comparable cash flows after investments' (i.e. cash flows before financing activities). In 2022 and 2023 share and business investments and sales are excluded; in 2022 share investments are excluded, which is also the case for 2021 page 23.

arrangement. Information on non-recurring cash flows might enhance the relevance of the information for understanding the entity's business; assessing the current performance of the entity; comparing entities using different accounting treatments for the same transactions; and assessing management's general performance.

g) Information about the impact of business combinations. Business combinations are causing disruption to the statement of cash flows and financial analyses and the information required by IFRS 3 *Business Combinations* seem to focus on the effects on the statement of financial position and the statement of profit or loss. Therefore, some consider that additional information is needed to understand how the statement of cash flows has been affected by business combinations. For example, information similar to the information required for revenue and profit or loss in IFRS 3 BC64(q) could be considered (information about revenue and profit or loss of the acquiree since the acquisition data and if the acquisition data had been as of the beginning of the annual reporting period). Information about the impact of business combinations might enhance the relevance of the information for assessing the current performance of the entity; assessing the ability of the entity to generate cash and cash equivalents; comparing entities using different accounting treatments for the same transactions; and assessing management's general performance.

h) Reconciliations. In relation to the IASB's Third Agenda Consultation, some respondents (including some users) commented that they have difficulty reconciling the statemen of cash flows to the other primary financial statements. Most of those respondents highlighted the need for more information about non-cash movements (see above)[118]. Similar input has been provided to EFRAG from preparers. Preparers thus experience that users of financial statements are asking them about how the information reconciles. From input collected by EFRAG, it also appears that some users struggle to understand the connections between the statement of profit or loss, statement of financial position and the statement of cash flows in relation to leases.[119] A survey conducted by the FASB in the USA showed support for a reconciliation between changes in statement of financial position line items and the corresponding changes in the statement of cash flows with strong support for reconciling revenue-related accounts (such as account receivables, contract assets, and contract liabilities)[120]. Also, Munter (2023), for statement of cash flows prepared in the USA, called for preparers to consider disclosing a reconciliation between changes in the statement of financial position items and the corresponding changes in the statement of cash flows.

3.54 In addition to these additional disclosures, there is also a request for further disaggregated information. This information is considered in the next section. Further disaggregated information can either be presented on the face of the statement of cash flows or in the notes.

[118] IASB agenda paper 24E for the March 2022 IASB meeting.

[119] Information collected at EFRAG round tables on the statement of cash flows.

[120] FASB (2023b).

Aggregation of information

3.55 Input collected by EFRAG indicates that some users find the degree of detail in the statement of cash flows of many entities insufficient[121]. This makes it difficult to understand the sources and uses of cash. IAS 7 allows too much flexibility on how to aggregate information in very different categories, meaning that entities can avoid disclosing really important information[122].

3.56 Similar information has been found in the USA. Munter (2023) thus called for preparers to consider to further disaggregate amounts reported in the statement of cash flows. In response to the 2021 FASB agenda consultation, investors and other financial statement users generally agreed that greater disaggregation of financial information in the statement of cash flows, or in the notes to the statement of cash flows, should be a top priority for the FASB to help them better perform their analyses (FASB 2021b). Respondents to the agenda consultation were, in relation to the statement of cash flows seeking information to understand: global tax risk (by providing information on the amount of cash taxes paid by jurisdiction or geographical segment and disaggregation of the types of taxes paid, such as the global intangible low-taxed income tax and the base erosion and anti-abuse tax), effects of business combinations to compare a company pre/ and post- acquisition, effects of environmental, social, and governance matters on financial statement line items, effects of foreign currencies on financial statement line items, cash flows of partially owned subsidiaries and equity method investments (investors would like to better understand cash flows from operations generated by these entities), and cash flows attributable to non-controlling interests. The FASB Investor Survey in 2022, showed that 'cash received from customers' received the most support and was the highest priority disclosure (FASB 2023b)[123]. One credit rating agency requested that the FASB consider requiring entities to separately disaggregate the types of cash interest paid by debt refinancing, financing fees, and non-debt-related interest. This disclosure would assist investors in calculating certain metrics such as funds from operations.

3.57 The input received by EFRAG has primarily focused on more disaggregated information in relation to:

a) The items whereby (operating) profit or loss is adjusted under the indirect method of presenting cash flows from operating activities. Particularly in relation to 'non-cash add-back items'[124]. The level of details provided in the statement of cash flows currently differs significantly from entity to entity.

b) Capital expenditures used for maintenance (maintenance CapEx) versus capital expenditures for growing a business (growth/investment CapEx)[125]. This distinction is, for example, important when calculating free cash flows and is thus related to the relevance of the information provided in relation to Objective 4. IAS 7 already encourage entities to disclose the aggregate amount of cash flows that represent

[121] For banks, see also Klumpes et al. (2009).

[122] ACCA (2020).

[123] 'Cash received from customers' was also mentioned as an important information if the indirect method of presenting cash flows from operating activities is used, by a member of the IASB's Analysts Representative Group in relation to the IASB/FASB project on financial statement presentation (IASB/FASB staff 2009).

[124] FASB (2021).

[125] Information collected at EFRAG round tables on the statement of cash flows.

increases in operating capacity separately from those cash flows that are required to maintain operating capacity. In addition to preparers, some users[126] of financial statements consider that it would be very difficult for entities to make such a distinction and resulting information could provide useful information. For preparers to provide the information, clear definitions of the different types of CapEx would be needed[127]. Others have suggested CapEx being broken further down into more items, to make it further help users making their own assessments on maintenance versus investment CapEx[128]. In addition to distinguishing between maintenance and growth CapEx, some also suggests considering 'not going out of business CapEx'. While recognising that information on CapEx is important, the view has, however, also been expressed that the financial statements is the appropriate location for this information[129].

c) Dividends to controlling versus non-controlling interest. IAS 7 does not distinguish between dividends to non-controlling interests and to common shareholders, some users have suggested that these should be presented separately in two-line items[130]. This information would, for example, be relevant for users estimating the value of the parent entity's equity by considering dividend payments (Objective 4). Respondents to the FASB agenda consultation have presented similar views[131].

d) Segment information on cash flows. As cash flows can be very different for different segments of a business–for example an insurance business and a bank business in the same group, some consider that segment information on cash flows is important.

Definitions of measures

3.58 Based on the input received, the following items that are not defined and are widely used by users have been highlighted:

a) Working Capital: Information collected by EFRAG indicates that users frequently inquire about the components of reported working capital, specifically focusing on liabilities, prepayments from customers, future cash flows. However, practice differs on what is included in this term. Some therefore suggest defining the term to enhance understandability and comparability[132]. In contrast, others do not think there is a need for a definition, as long as entities provide disclosures on what they believe working capital items are and what are the changes[133]. Respondents to the FASB agenda consultation have similarly observed that, although questions on cash flow information are limited, there have been past requested about the key drivers of variability across periods, such as accounts receivable fluctuations, working capital

[126] Information collected at EFRAG round tables on the statement of cash flows.

[127] Information collected at EFRAG round tables on the statement of cash flows.

[128] Information collected at EFRAG round tables on the statement of cash flows.

[129] Information collected at EFRAG round tables on the statement of cash flows.

[130] Information collected at EFRAG round tables on the statement of cash flows.

[131] Munter (2023).

[132] Information collected at EFRAG round tables on the statement of cash flows.

[133] Information collected at EFRAG round tables on the statement of cash flows.

changes, and nonrecurring items[134]. The 2021 FASB agenda consultation asked preparers what requests or questions, if any, their company received from analysts on cash flow information. A few preparers provided feedback on what cash flow information requests their company receives from analysts. Three preparers stated that additional details requested by analysts are minimal and that the frequency of those inquiries is relatively low. Of the inquiries that were received, one preparer explained that past requests related to key drivers of variability across periods, such as accounts receivable fluctuations, working capital changes, and nonrecurring items. Another preparer noted that it has received questions on the clarification of the nature and definition of certain cash flows or noncash flow activities, the purchase and sale of certain assets, and intended use of cash by management. Separately, two trade groups stated that it is relatively rare for their members to receive inquiries or requests related to additional information on the statement of cash flows. (FASB 2021b)

b) Maintenance vs. growth Capital Expenditure (CapEx): Even if preparers would currently like to distinguish between maintenance and growth capital expenditure, the absence of clear definition of assets makes it difficult to distinguish these two types of expenditures in a manner resulting in information that is comparable between entities[135]. Should a requirement be introduced on the distinction, the terms would therefore have to be defined.

c) Net Debt: Some entities provide a net debt metric[136], and, as it will appear in the following Chapter 4:, a net debt statement could also be considered as an alternative to the statement of cash flows. Some consider net debt to be a key performance metric that is completely ‘ignored’, even with the IAS 7 Disclosure Initiative aimed at enhancing information related to changes in debt. The amendments to IAS 7 require disclosure of information to help users evaluate changes in liabilities arising from financing activities, however, the information provided is still insufficient [137].The lack of a definition of net debt results in non-comparability[138]. Defining net debt, may, however, not been easy[139].

d) Free Cash Flow (FCF): Free cash flows is a metric often used to value an entity and frequently reported by entities in financial reports[136]. The term is not defined in IFRS literature. The lack of a definition may result in inconsistencies on how it is calculated by analysts and reported by entities.

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[134] FASB. 2021

[135] Information collected at EFRAG round tables on the statement of cash flows.

[136] In a study perform by EFRAG in relation to IFRS 18 on APMs, MPMs and KPIs used in entities annual reports, 48% of the European entities selected reported a free cash flow metric. 41% reported a net debt metric. In relation to the statement of cash flows, other metrics reported (but significantly less frequently) were: free operating cash flows (where only operational investments are deducted from operating cash flows), adjusted free cash flows, net cash, cash flows before deduction of interest and income tax and funds from operations.

[137] ACCA (2020).

[139] Paragraph BC11 of the Basis for Conclusion on IAS 7.

3.59 While some consider that the IASB should define (some of) the measures listed above, others do not consider that the IASB should waste resources in doing so. They thus expect that developing uniform definitions of these items may be challenging and not beneficial to users, given that they often calculate them differently and may prefer to continue using their own existing definitions when performing their analyses. Also, some consider it inappropriate to try to define, in financial reporting regulation, non-GAAP measures. Nonetheless, it is important that companies provide additional disclosures when presenting these items in the statement of cash flows[140]. An alternative to providing a definition could be to require a reconciliation of some of the measures to figures included in the financial statements.

3.60 An approach consistent with the statement above was the introduction of the IFRS 18 new requirements related to performance measures in the statement of financial performance. IFRS 18 requires entities to provide additional information about 'management-defined performance measures' (MPMs) in a single note, including how the measure is calculated, how it provides useful information to users and a reconciliation to the most comparable subtotal as specified by IFRS Accounting Standard[141]. Users have welcomed these performance measures disclosures related to the statement of financial performance, as it disaggregates further information and provide tax and non-controlling interest disclosures that are particularly useful for investors[142]. Hence, a similar approach could be considered to be extended to performance measures presented in the statement of cash flows.

Cohesiveness with other primary financial statements

3.61 Chapter 2 highlighted the benefits of using the statement of cash flows in conjunction with the rest of the financial statements. The input collected by EFRAG has revealed that using the statement of cash flows together with the other financial statements provides a holistic view on the company's performance[143] and enables the reconciliation between the financial statements[144].

3.62 Although IFRS 18 brought changes to the structure of the statement of profit or loss, containing operating, investing, financing categories, there is no alignment to those in IAS 7 as they have different meanings[145]. Therefore, income and expenses and the associated cash flows may be classified across different categories, resulting in three main issues:

a) It may be challenging to directly compare line items in the statement of profit or loss and the statement of cash flows[146]

b) It may be difficult to reconcile cash flows with other items in the financial statements[147].

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[140] Information collected at EFRAG round tables on the statement of cash flows.

[141] EY (2024).

[142] Cooper & Jullens (2024).

[143] Information collected at EFRAG round tables on the statement of cash flows.

[144] Information collected at EFRAG round tables on the statement of cash flows.

[145] Deloitte (2024).

[146] Information collected at EFRAG round tables on the statement of cash flows.

[147] Information collected at EFRAG round tables on the statement of cash flows.

c) Using the same labelling for categories under IFRS 18 and IAS 7, despite the lack of reciprocity between the two financial statements, may lead to confusion[148].

3.63 The IASB, in its Financial Statement Presentation project, has attempted to achieve cohesiveness across all financial statements, however, this proved difficult. Input collected by EFRAG has on the one hand indicated that some do not prefer complete cohesiveness. For example, some are concerned that with the treatment of transactions in the statement of financial position influencing the classification of the related cash flows. For instance, payments for supplier finance transactions are classified under the financing category in the statement of cash flows simply because the trade payable is treated as debt in the statement of financial position. This classification may, according to these people, not accurately represent the nature of the transaction[149]. Similarly some users prefer acquisitions of PPE to be reflected as investing activities in the statement of cash flows, while the corresponding 'depreciations' would be classified in the operating category in the statement of profit or loss. This would mean that it would be difficult to achieve complete cohesiveness.

3.64 On the other hand, others, for example, consider that reflecting investments in cash flows from operating activities would better align with the concept of free cash flows and that these expenditures are often related to the core activity of an entity[150]. Also lack of cohesiveness create confusion.

3.65 There are thus views both in favour and against a complete alignment. If a complete alignment may not be considered desirable, it could be considered to amend the categories in IFRS 18 and IAS 7 so that they would not carry similar names, but have different content.

Presentation of cash flows from operating activities

3.66 IAS 7.18 requires entities to present cash flows from operating activities using either the:

> **Direct method**: major classes of gross cash receipts and gross cash payments are disclosed.
>
> **Indirect method:** profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

3.67 The option to use either method creates differences in how entities present cash flows from operating activities. This is especially challenging when different methods are used within the same group, which can potentially lead to inconsistencies in reporting[151].

[148] Information collected at EFRAG meetings.

[149] Information collected at EFRAG round tables on the statement of cash flows.

[150] Deller (2024).

[151] Information collected at EFRAG round tables on the statement of cash flows

3.68 Some may argue that having one way of presenting cash flows from operating activities would enhance comparability and thus benefit users of financial statements, however, removing the option for entities to apply the direct or indirect could be costly for preparers and would, according to some, have limited benefits for users[152]. Improving the disclosures including information on both direct and indirect cash flows would be another alternative and this might enhance transparency and accuracy of financial information used by analysts, and consequently reduce forecasting errors[153] .

3.69 The following sections outline the advantages and disadvantages of the direct and the indirect method.

Direct method

3.70 Under the direct method, information about major classes of gross cash receipts and gross cash payments, can be obtained from:

a) the accounting records of the entity; or

b) by adjusting sales, cost of sales and other items in the statement of comprehensive income.

Advantages

Clarity and understandability

3.71 IAS 7.19 encourages entities to apply the direct method to present income from operating activities, as it provides information useful for estimating future cash flows. Similarly, the FASB[154] and the SEC encourage issuers to consider using the direct method to enhance investors' understanding of the statement of cash flows and the overall financial statements[155].

3.72 The direct method is often considered more intuitive and easier to understand by users[156]. Moreover, US-based investors have confirmed that the indirect method is not intuitive and lacks sufficient information for their decision-making process. The additional detail provided by the direct method helps finance staff create forecasts that executives can easily understand[157].

[152] Information collected at EFRAG round tables on the statement of cash flows.

[153] Information collected at EFRAG round tables on the statement of cash flows.

[154] ASC 230-10-45-25.

[155] Munter (2023).

[156] Information collected at EFRAG round tables on the statement of cash flows. Also, for example, Klammer & Reed found that the direct method resulted in less variability in the loans that participants would grant an entity compared with the indirect method. Similar results were found by Kojima (2012). Ward et al. (2009) finds that entities using the direct method have significantly less nonarticulation than companies using the indirect method.

[157] Munter (2023).

Granularity of information

3.73 Academic studies have shown that information presented using the direct method is incrementally useful beyond that provided by the indirect method and other financial statements[158]. For example, the direct cash flow components of cash receipts from customers may be valuable information within the operating activities section of the direct statement of cash flows and useful in forecasting future cash flows[159].

3.74 The direct method has also been associated with lower levels of information asymmetry, compared to the indirect method, reducing the cost of obtaining information and consequently lower the cost of raising capital for entities[160]. Some studies have also reported that it leads to better prediction of future firm performance and has a stronger association with share prices[161]. There are, however, also academic studies that find the indirect method to be superior[162].

3.75 Following the 2021 FASB Agenda Consultation, investors have indicated a preference for requiring the direct method, as it would improve decision-making and liquidity information (e.g., cash collected from customers that is only available using the direct method). Moreover, they emphasised that the direct method should be required because there is a greater need for transparency and detail of the operating section, and the direct method serves as a useful analysis tool[163].

Disadvantages

Complex and challenging application

3.76 Input collected by EFRAG indicates that preparers consider these challenges in using the direct method, mainly due to their complex corporate structure, different currencies, different reporting entities, multiple bank accounts across countries, and high volume of transactions. In some cases, they noted that the system in place does not provide practical support to achieve the presentation using the direct method, and it is even hard to understand to which category each payment relates to (some transactions may combine different categories)[164].

3.77 In the 2021 FASB agenda consultation, a majority of preparers, alongside trade groups and state CPA societies noted the potential complexity and associated of requiring the direct method. Companies with complex operations and structures would face increased costs associated with preparing the statement of cash flows using the direct method[165].

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[158] See, for example, Hales and Orpurt (2003) and Cheng & Hollie (2008).

[159] See, for example, Nallareddy et al. (2020), Hales and Orpurt (2003) and Krishnan & Largay (2000).

[160] See, for example, Kent & Bu (2020).

[161] See, for example, Bradbury (2011).

[162] See, for example, Farshadfar, S. (2012).

[163] Munter (2023).

[164] Information collected at EFRAG round tables on the statement of cash flows.

[165] Munter (2023).

Limited usefulness of large figures that are not informative

3.78 Some preparers and users doubt that information provided under the direct method would help analysts to improve their forecasting[166]. Input collected by EFRAG has indicated that users are interested in understanding differences between operating profit and the related cash flows (e.g., Objective 1b.1). Under the indirect method large figures would attract the attention of analysts, without being informative for this purpose[167].

Indirect method

3.79 Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:

a) changes during the period in inventories and operating receivables and payables;

b) non-cash items such as depreciation, provisions, deferred taxes, unrealised foreign currency gains and losses, and undistributed profits of associates; and

c) all other items for which the cash effects are investing or financing cash flows.

Advantages

It is widely used

3.80 Although IAS 7 encourages the direct method, most entities present income from operating activities using the indirect method[168]. However, it has been observed that preferences vary across jurisdictions and organisations[169].

It provides useful information and the link with the other statements

3.81 Input collected by EFRAG from European users of financial statements, indicated that they had clear preference for the indirect method of presenting cash flows from operating activities. They considered the indirect method was helpful for forecasting growth and understanding how much cash flow is being absorbed by working capital[170].

3.82 The indirect method provides a link between the cash flow statement and the statement of financial performance, which can be used alongside users' analyses.[171]

[166] Information collected at EFRAG round tables on the statement of cash flows.

[167] Information collected at EFRAG round tables on the statement of cash flows.

[168] Hales & Orpurt (2003).

[169] Information collected at EFRAG round tables on the statement of cash flows.

[170] Information collected at EFRAG round tables on the statement of cash flows.

[171] Information collected at EFRAG round tables on the statement of cash flows.

Disadvantages

Less detailed information

3.83 A limitation of the indirect method is that that it does not show actual cash flows, turning the cash flow statement into a reconciliation of other statements[172]. This means that the information needed to calculate cash flows from operating activities using the indirect method is already available in the other financial statements, without providing any new information[173] for users. The direct method is more useful for users in some cases, such as obtaining information on supply finance arrangements[174].

Variability in application

3.84 There is significant variability in how companies and industries present cash flows using the indirect method, which makes comparability and analysis more difficult for users[175].

172 Information collected at EFRAG round tables on the statement of cash flows.

173 Greuning et al. (2013).

174 Information collected at EFRAG round tables on the statement of cash flows.

175 Munter (2023).

CHAPTER 4: ALTERNATIVES TO THE STATEMENT OF CASH FLOWS

This Chapter discusses alternative approaches to the statement of cash as prepared in accordance with IAS 7 for non-financial entities. The alternatives considered are those that have been brought to the attention of EFRAG. The list of possible alternatives is therefore incomplete and EFRAG does not necessarily agree with the listed alternatives. The issues with the statement of cash flows for non-financial entities were addressed in Chapter 3. This Chapter builds on the discussion by examining alternatives. The alternatives considered are: a statement of changes in net debt; a statement of changes in working capital; statement of changes in other liquid assets; and a statement of changes in assets used the entity's liquidity management.

4.1 The statement of cash flow, despite its importance, is subject to its limitations. Chapter 3 described the issues with the statement of cash flows as currently prepared, which could be addressed following targeted improvements or a comprehensive review of IAS 7. Chapter 6 discusses further this topic.

4.2 The objective of this chapter is to discuss different approaches for non-financial entities that could be alternative (or supplements) to the statement of cash flows, as required by IAS 7.

4.3 Chapter 2 highlighted that investors often reconstruct the statement of cash flows and use their own methods in estimating cash flows (Objective 4). Accordingly, it could be considered whether the statement of cash flows could be replaced (or complemented) by another statement. The following alternatives have been brought to the attention of EFRAG:

a) a statement of changes in net debt/net debt reconciliation;

b) a statement of changes in working capital;

c) a statement of changes in other liquid assets; and

d) a statement of changes in assets used in liquidity management

4.4 This list is non-exhaustive and does not necessarily represent alternatives EFRAG would agree with. The alternatives are further described in the following sections.

Net Debt Reconciliation

4.5 Input collected by EFRAG suggests that an alternative to the statement of cash flows could be a 'net debt reconciliation', presenting the reconciliation of each component of net debt. In this context, a net debt reconciliation thus means a reconciliation of net debt from one date to another. Illustration 1 provides an example of such a statement together with a table showing the components of net debt. Illustration 2 provides an example of a graphical illustration of changes in net debt and Illustration 3 illustrates a table showing the components of net debt. Best practices of presenting a net debt reconciliation were considered in the Financial Reporting Lab project report on Net Debt Reconciliations. In this report it was considered that best practice highlight key movements and show cash and non-cash drivers of changes to net debt[176]:

[176] Financial Reporting Lab. (2012).

a) Cash drivers: Investors are able to reconcile items in the financial statements with the relating changes in net debt[177]. It was noted that showing separately unusual cash items is very important. Information on cash movements can be used to understand how an entity's net debt movements reconcile to what management's expectation of cash flows. Hence, users can assess the effectiveness of management's financial policy and identification of any possible variance. The statement also captures working capital absorption, debt-servicing dynamics and FX movements.

b) Non-cash drivers: Investors highlight reconciling items that are non-cash movements in net debt and are typically useful to be shown separately: finance lease additions, foreign exchange and fair value movements, acquired debt and disposals. Non-cash movements. Input received from EFRAG suggested that such a statement can help solve issues related to non-cash transactions[178].

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[177] Financial Reporting Lab. (2012).

[178] Information collected at EFRAG round tables on the statement of cash flows.

Illustration 1. Illustration 10: Composition and changes in net debt

29. Net debt

We define net debt as the amount of borrowings and financing derivatives less cash and current financial investments.

(a) Composition of net debt

Net debt is comprised as follows:

	2023 £m	2022 £m	2021 £m
Cash and cash equivalents (see note 20)	**163**	204	157
Current financial investments (see note 15)	**2,605**	3,145	2,342
Borrowings (see note 21)	**(42,985)**	(45,465)	(31,220)
Financing derivatives[1] (see note 17)	**(756)**	(693)	175
	(40,973)	(42,809)	(28,546)

1. The financing derivatives balance included in net debt excludes the commodity derivatives (see note 17).

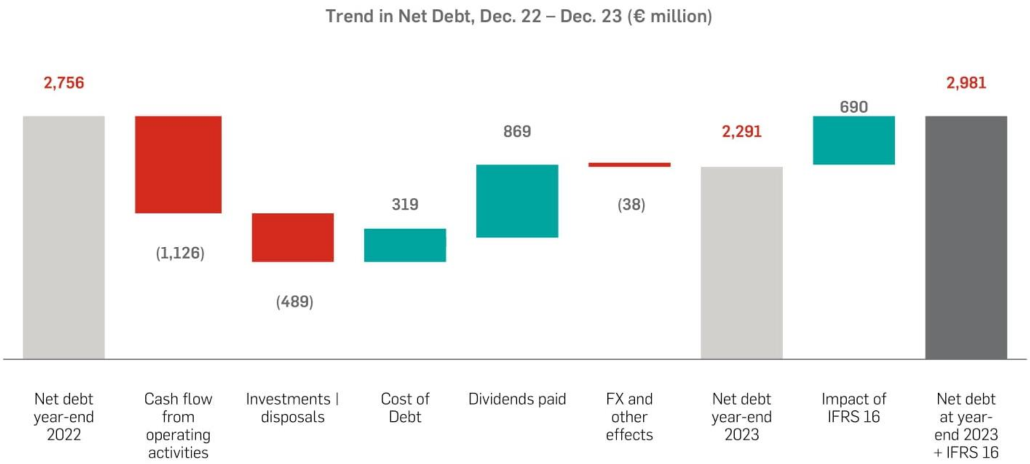
(b) Analysis of changes in net debt

	Notes	Cash and cash equivalents £m	Financial investments[1] £m	Borrowings £m	Financing derivatives £m	Total[2] £m
At 1 April 2020		73	1,998	(30,794)	133	(28,590)
Cash flow		95	429	(2,336)	4	(1,808)
Fair value gains and losses		—	14	159	31	204
Foreign exchange movements		(7)	(106)	1,710	—	1,597
Interest income/(charges)	6	—	7	(946)	7	(932)
Other non-cash movements		—	—	(136)	—	(136)
Reclassification to held for sale	10	(4)	—	1,123	—	1,119
At 1 April 2021		157	2,342	(31,220)	175	(28,546)
Cash flow	29(c)	9	752	(9,993)	262	(8,970)
Fair value gains and losses		—	(12)	286	(604)	(330)
Foreign exchange movements		5	53	(652)	—	(594)
Interest income/(charges)	6	—	43	(1,177)	(59)	(1,193)
Other non-cash movements		—	(15)	34	—	19
Acquisition of NGED	37	44	69	(8,286)	26	(8,147)
Reclassification to held for sale[3]	10	(11)	(87)	5,543	(493)	4,952
At 1 April 2022		204	3,145	(45,465)	(693)	(42,809)
Cash flow	29(c)	(48)	(651)	5,268	455	5,024
Fair value gains and losses		—	(18)	367	(348)	1
Foreign exchange movements		7	61	(1,311)	—	(1,243)
Interest income/(charges)	6	—	73	(1,658)	(170)	(1,755)
Other non-cash movements		—	—	(283)	—	(283)
Reclassification to held for sale[3]	10	—	(5)	97	—	92
At 31 March 2023		**163**	**2,605**	**(42,985)**	**(756)**	**(40,973)**
Balances at 31 March 2023 comprise:						
Non-current assets		—	—	—	263	263
Current assets		163	2,605	—	100	2,868
Current liabilities		—	—	(2,955)	(93)	(3,048)
Non-current liabilities		—	—	(40,030)	(1,026)	(41,056)
		163	**2,605**	**(42,985)**	**(756)**	**(40,973)**

1. Cash flows on current financial investments comprise £65 million (2022: £29 million; 2021: £7 million) of interest received and £586 million of cash inflows (2022: £781 million outflows; 2021: £436 million outflows) of net cash flow movements in short-term financial investments, as presented in the consolidated cash flow statement.
2. Includes accrued interest at 31 March 2023 of £401 million (2022: £351 million; 2021: £263 million).
3. Reclassification to held for sale in the year ended 31 March 2022 represented the opening net debt position of the UK Gas Transmission business (see note 10). In the current year the reclassification to held for sale relates to the disposal of NECO which was not classified as a discontinued operation.

National Grid 2023 Annual Report p. 184.

Illustration 2. Graphical illustration of changes in net debt



CEPSA Group Annual Report 2023, page 114.

Illustration 3. Example of table showing components of net debt

€m, period ended	31.12.2022	31.12.2023
Cash & cash equivalents		
Cash	-35.9	-47.7
Cash equivalents	0.0	0.0
Total cash & cash equivalents	**-35.9**	**-47.7**
Financial liabilities		
Intercompany short-term borrowing	104.7	10.4
Third parties short-term borrowing	1.1	57.7
Put option Nethys SA		279.0
Third parties long-term borrowing		**81.0**
Intercompany long-term borrowing	120.8	1 843.7
Total borrowings	**226.6**	**2 271.8**
Net debt (Financial liabilities minus cash and cash equivalents)	**190.7**	**2 224.0**

Orange SA Annual Report 2023, page 28.

4.6 In addition to depicting cash movements and non-cash movements, the statement can be helpful when trying to understand an entity's debt structure, especially when it appears to be complex.

4.7 While the amount of cash can easily be affected just before the balance sheet by borrowing money, the net debt will not be affected by such actions[179]. Changes in net debt may therefore be better related to (and for estimation of) the value of an entity, such as enterprise value.

[179] Information collected at EFRAG round tables on the statement of cash flows.

4.8 The usefulness of a net debt statement was confirmed by some respondents (mostly users) to the IASB's third agenda consultation, who suggested the IASB to require entities to present a statement of changes in net debt, as it provides useful information for estimating an entity's enterprise value[180]. Such a statement can be used for equity valuation purposes and for investigating potential issues with debt or liquidity[181]. Therefore, a net debt reconciliation serves a similar purpose and could serve as an alternative to the statement of cash flows.

Statement of changes in working capital

4.9 As an alternative to the statement of cash flows, non-financial entities could provide a statement of changes in working capital. This statement would detail the changes in current assets and current liabilities during the reporting period providing a clearer understanding of the net change in working capital (increase or decrease). Some entities already voluntarily provide this information in a simple statement, particularly when using the indirect method for presenting operating cash flows, by detailing the individual increases or decreases in current assets and liabilities to explain the net change in working capital (Illustration 4 provides an example of such a statement). A study examining the relationship between accounting flow variables and company liquidity has shown that changes in working capital from operations are correlated with a company's liquidity[182]. Therefore, such a statement might offer some insights into a company's liquidity position.

Illustration 4. Example of Statement of changes in net working capital

Description	Amount (Millions)
Beginning Working Capital	38 058
Additions	
Increase in Accounts Receivable	1 065
Increase in Inventory	1 005
Increase in Other Current Assets	1 550
Total Additions	**3 620**
Deductions	
Increase in Accounts Payable	2 382
Increase in Accrued Expenses	1 583

180 IASB. (2022).

181 Financial Reporting Lab. (2012).

182 Noor et al. (2012).

Description	Amount (Millions)
Increase in Deferred Revenue	1 089
Total Deductions	**5 054**
Change in Working Capital	**(1 434)**
Ending Working Capital	**36 624**

Statement of changes in other liquid assets

4.10 Given that the current definition of 'cash and cash equivalents' would not include items that very easily could be ed turned into cash, but would be subject to a significant change in value being included, an alternative approach to the statement of cash flows could be to provide instead/in addition a statement of changes in (other) liquid. Such a statement could detail separately the amount of and changes related to liquid resources and could provide information on how the entity manages such resources. A similar approach has been discussed in the context of the IAS 7 Disclosure Initiative, which suggested that a separate section contained in the statement of cash flows could be devoted to the management of liquid resources[183]. However, to implement such an alternative, it should be first clarified what is considered to be 'liquid resources'.

Statement of changes in assets used in liquidity management

4.11 The items the management of an entity considers for its liquidity management may/will often not correspond to the items meeting the definition of cash equivalents. To better illustrate how liquidity is managed by the entity, a statement of assets used in liquidity management could thus be provided.

[183] IASB agenda paper 11B for the December 2014 IASB meeting.

CHAPTER 5: THE STATEMENT OF CASH FLOWS FROM FINANCIAL INSTITUTIONS

This Chapter discusses the relevance of the statement of cash flows for financial institutions. The relevance of the statement of cash flows likely depends on the specific activities of the financial institution. The issues are thus different for banks and insurance companies, and likely also different for different types of banks and insurance companies. The Chapter does not present a view on whether the statement of cash flows from banks and insurance companies is useful but provides some arguments for why the statement of cash flows could be regarded as having limited usefulness for the deduced objectives listed in Chapter 2 for entities in the two types of industries.

Most of the input, EFRAG has collected has represented the view that the statement of cash flows is generally not particularly useful for financial institutions, although there could be specific types of financial institutions for which the information could have some relevance as the term 'financial institutions' covers a broad spectrum of entities. Users have, however, presented mixed views. Similarly, academic research has provided mixed results on the issue for banks.

In addition to the questionable relevance of the statement of cash flows for financial institutions, the issues with the statement of financial institutions are facing similar issues to non-financial entities. However, the particularities of financial institutions mean that the solutions that may result in the most useful information for non-financial entities in relation to, for example, what 'cash and cash equivalents' should include, and classification may not also result in the most useful information for banks.

The Chapter presents alternatives or supplements to the statement of cash flows that have been brought to the attention of EFRAG. The list is non-exhaustive and the listed alternatives would not necessarily be supported by EFRAG. The list includes: presentation of regulatory ratios (for banks); information on liquidity (for banks and insurance companies); information on dividend payout capacity (for banks); presentation of a statement of (regulatory) capital flows (for banks (and insurance companies)); a statement of cash flows without the categories (for banks and insurance companies); information about the collection and uses of cash resources (for banks and insurance companies); a standardised table with stress-testing scenarios (for banks and insurance companies); and information on cash flows related to interests and loan originations and repayments (for banks).

Objectives/purpose and usages of the statement of cash flows from financial entities

5.1 Neither the Conceptual Framework nor IAS 7 distinguish the benefits of the information provided in the statement of cash flows between financial and non-financial entities. It is considered that financial entities, like non-financial entities need cash for the same reasons.

> Users of an entity's financial statements are interested in how the entity generates and uses cash and cash equivalents. This is the case regardless of the nature of the entity's activities and irrespective of whether cash can be viewed as the product of the entity, as may be the case with a financial institution. Entities need cash for essentially the same reasons however different their principal revenue-producing activities might be. They need cash to conduct their operations, to pay their obligations, and to provide returns to their investors. (IAS 7, paragraph 3)

5.2 Accordingly, IAS 7 requires all entities to present a statement of cash flows and provides no exemption for financial entities.

5.3 As the Conceptual Framework and IAS 7 do not distinguish between statements of cash flows prepared for financial and non-financial entities, it also follows that the deduced objectives listed in Chapter 2 above, are also intended to apply to financial institutions.

5.4 It is, however, questioned to what extent the statement of cash flows is useful for financial institutions[184] in meeting the deduced objectives. The issues with the usefulness, varies with the different types of financial institutions. The following sections accordingly consider the usefulness of the statement of cash flows for the deduced objectives for banks and insurance companies separately[185]. The issues listed would also be relevant for other types of entities and organisations such as lessors[186]. Illustration 5 and Illustration 6 provide the statement of cash flows of a bank and an insurance company.

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[184] See, for example, EFRAG (2015). Information collected at EFRAG round tables on the statement of cash flows also confirmed this view

[185] When considering the statement of cash flows for insurance companies, also 'saving life insurances' (pension insurances) are considered. Pension funds covered by IAS 26 are not required to prepare a statement of cash flows and are accordingly not considered.

[186] EFRAG (2016).

Illustration 5. The statement of cash flows of a bank

Consolidated Statement of Cash Flows

in € m.	2023	2022	2021
Net Income (loss)	4,892	5,659	2,510
Cash flows from operating activities:			
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Provision for credit losses	1,505	1,226	515
Restructuring activities	220	(118)	261
Gain on sale of financial assets at fair value through other comprehensive income, equity method investments and other	(84)	128	(276)
Deferred income taxes, net	(553)	(852)	19
Impairment, depreciation and other amortization, and accretion	3,111	3,529	3,568
Share of net income from equity method investments	107	(129)	(197)
Income (loss) adjusted for noncash charges, credits and other items	9,197	9,443	6,400
Adjustments for net change in operating assets and liabilities:			
Interest-earning time deposits with central banks and banks	(699)	102	97
Central bank funds sold, securities purchased under resale agreements, securities borrowed	(3,285)	(3,046)	102
Non-Trading financial assets mandatory at fair value through profit and loss	793	1,511	(12,124)
Financial assets designated at fair value through profit or loss	93	(31)	309
Loans at amortized cost	8,556	(5,101)	(41,628)
Other assets	(1,384)	(459)	8,046
Deposits	1,771	11,686	33,269
Financial liabilities designated at fair value through profit or loss and investment contract liabilities[1]	29,493	(6,046)	11,144
Central bank funds purchased, securities sold under repurchase agreements, securities loaned	2,456	(187)	(3,249)
Other short-term borrowings	4,534	1,065	477
Other liabilities	777	12,377	(17,823)
Senior long-term debt[2]	(11,880)	(17,019)	(6,191)
Trading assets and liabilities, positive and negative market values from derivative financial instruments, net	(35,616)	2,249	19,559
Other, net	801	(8,658)	(1,341)
Net cash provided by (used in) operating activities	5,606	(2,113)	(2,952)
Cash flows from investing activities:			
Proceeds from:			
Sale of financial assets at fair value through other comprehensive income	15,646	15,450	52,131
Maturities of financial assets at fair value through other comprehensive income	19,437	21,557	21,424
Sale of debt securities held to collect at amortized cost	(0)	0	67
Maturities of debt securities held to collect at amortized cost	8,025	6,519	5,468
Sale of equity method investments	20	118	23
Sale of property and equipment	33	22	114
Purchase of:			
Financial assets at fair value through other comprehensive income	(38,648)	(42,991)	(46,801)
Debt Securities held to collect at amortized cost	(4,859)	(16,696)	(7,166)
Equity method investments	(60)	(171)	(100)
Property and equipment	(422)	(337)	(550)
Net cash received in (paid for) business combinations/divestitures	(361)	439	(5)
Other, net	(1,386)	(1,086)	(1,010)
Net cash provided by (used in) investing activities	(2,576)	(17,175)	23,595
Cash flows from financing activities:			
Issuances of subordinated long-term debt	1,432[3]	2,716	1,146
Repayments and extinguishments of subordinated long-term debt	(1,471)[3]	(90)	(42)
Issuances of trust preferred securities	0[4]	0	0
Repayments and extinguishments of trust preferred securities	(225)[4]	0	(504)
Principal portion of lease payments	(534)	(607)	(679)
Common shares issued	0	0	0
Purchases of treasury shares	(857)	(695)	(346)
Sale of treasury shares	0	0	35
Additional Equity Components (AT1) issued	0	2,000	2,500
Additional Equity Components (AT1) repaid	0	(1,750)	0
Purchases of Additional Equity Components (AT1)	(400)	(4,058)	(2,662)
Sale of Additional Equity Components (AT1)	415	4,074	2,642
Coupon on additional equity components, pre tax	(498)	(479)	(363)
Dividends paid to noncontrolling interests	(100)	(96)	(85)
Net change in noncontrolling interests	(5)	5	(13)
Cash dividends paid to Deutsche Bank shareholders	(610)	(406)	0
Net cash provided by (used in) financing activities	(2,852)	614	1,630
Net effect of exchange rate changes on cash and cash equivalents	(2,036)	4,354	1,345
Net increase (decrease) in cash and cash equivalents	(1,857)	(14,320)	23,618
Cash and cash equivalents at beginning of period	165,626	179,946	156,328
Cash and cash equivalents at end of period	163,768	165,626	179,946
Net cash provided by (used in) operating activities include			

Deutsche Bank Annual Report 2023, page 215.

Illustration 6. The statement of cash flows of an insurance company

	Note	2023		2022 Restated (*)	
Cash and cash equivalents as at 1 January, from continued operations	1		1,176		2,142
Cash and cash equivalents as at 1 January, from disposal group held for sale			89		
Cash and cash equivalents as at 1 January			**1,265**		**2,142**
Result before taxation			**1,428**		**1,489**
Adjustments to non-cash items included in result before taxation:					
Remeasurement RPN(I)	13	64		(139)	
Net insurance service and finance result and result on sales and revaluations	18 & 19 & 20	409		776	
Share in result of equity-accounted investments	4	(439)		(508)	
Depreciation, amortisation and accretion (non-attributable to insurance contracts)	24	342		389	
Net impairment loss on financial assets and change in impairment	23	62		68	
Provisions		(10)		1	
Share-based compensation expense	24	(2)		3	
Total adjustments to non-cash items included in result before taxation			426		590
Changes in operating assets and liabilities:					
Insurance contracts assets and liabilities	9	(943)		(1,576)	
Reinsurance contracts assets and liabilities	10	(169)		(176)	
Investment contracts liabilities		(415)		605	
Net changes in all other operational assets and liabilities		23		247	
Income tax paid		(226)		(160)	
Total changes in operating assets and liabilities			(1,730)		(1,060)
Cash flow from operating activities			**124**		**1,019**
Investing activities within the group		(4)		(15)	
Purchases of financial investments	2	(10,994)		(14,313)	
Proceeds from sales and redemptions of financial investments	2	11,781		13,858	
Derivatives assets and liabilities (relating to investing activities)		116		(76)	
Cash flows relating to repurchase agreements		426		76	
Purchases of investment property	3	(256)		(162)	
Proceeds from sales of investment property	3	239		451	
Purchases of property and equipment	5	(146)		(82)	
Proceeds from sales of property and equipment	5	21		21	
Acquisitions of subsidiaries and associates (including capital increases in associates)		(91)		(493)	
Divestments of subsidiaries and associates (including capital repayments of associates)		180			
Dividend received from associates	4	171		184	
Purchases of intangible assets	6	(93)		(78)	
Proceeds from sales of intangible assets	6	3		12	
Cash flow from investing activities			**1,353**		**(617)**
Proceeds from the issuance of borrowings	11	34		34	
Payment of borrowings	11	(117)		(167)	
Purchases of treasury shares				(91)	
Dividends paid to shareholders of parent companies		(540)		(765)	
Dividends paid to non-controlling interests		(242)		(268)	
Repayment of capital (including minority interest)		(3)		(2)	
Cash flow from financing activities			**(868)**		**(1,259)**
Effects of foreign exchange differences on cash and cash equivalents			**1**		**(20)**
Cash and cash equivalents as at 31 December, from continued operations	1		1,875		1,176
Cash and cash equivalents as at 31 December, from disposal group held for sale					89
Cash and cash equivalents as at 31 December			**1,875**		**1,265**
Supplementary disclosure of operating cash flow information					
Interest received		75		179	
Dividend received from financial investments		1,777		1,573	
Interest paid		(242)		(174)	

(*) See 'Summary of accounting policies and estimates', section 2.

Ageas Annual Report 2023, page 99.

The usefulness of the statement of cash flows for banks

5.5 There are many types of entities that can be termed a bank and operate under a banking licence. A 'bank' can thus be a platform that facilitates finance arrangements, an entity that buys and sells stock and bonds following instructions by its customers; and an institution that borrows money from some customers and other banks (including central banks) and lend money out to other customers and banks. The following text has mainly been written with the latter type of 'banks' in mind, and all the aspects may accordingly not be relevant for other types of banks, including 'banks' that are starting to operate a business and accordingly could have a cash shortage, on which the statement of cash flows could provide relevant information.

5.6 One of the main issues with the statement of cash flows for banks is that, unlike non-financial entities, there is the lack of a cash conversion feature for transactions affecting the statement of financial position[187]. Non-financial entities would often first spend cash to purchase input (that is not 'cash or cash equivalents'). That input is then transformed into 'output' and can be sold to customers, from which the entity would then eventually receive some cash. Activities/transactions of non-financial entities will accordingly typically either involve a cash outflow or a cash inflow which will correspond to an income or expense unless the activities/transactions are related to financing or investing activities. In other words, the business model of non-financial entities involves converting non-cash inputs (acquired for cash) into cash and users can therefore use the statement of cash flows to assess the ability of the entity to generate cash. This is generally different for banks[188] (depending on the main activity of the bank). For a bank, the good transferred or purchased is often 'cash and cash equivalents'. For example, when a bank issues a loan (which could be considered as a sale), it would either have a cash outflow (if cash is transferred out of the bank) or would credit the loan amount to the current account of a customer (e.g., increase deposits and loans at amortised cost)[189]. Accordingly, that activity may or may not have any impact of the 'cash and cash equivalents' of the bank, and whether and when it would have a cash impact could depend on the action of the customer rather than the bank (when the customer would withdraw the money from the bank). When interest would accrue and be payable by the customer, this could result in a cash inflow if the customer would transfer the cash from another bank. However, the customer would often have an account by the bank (which could be a demand deposit in the financial statements of the bank) and the 'payment' of the interest would therefore often not result in changes in 'cash and cash equivalents' of the bank. Instead, an asset that would not be 'cash and cash equivalents' (e.g., loans at amortised cost) would decrease at the same amount as a liability (e.g. 'deposits').

5.7 Another main issue is that it can be argued that the distinction between investing, financing and operating activities, which is a main element of the statement of cash flows, is not meaningful for banks. This is because most investing and financing activities could be said to be part of a banks' revenue producing activities. Also, different maturity periods of the loans of a bank, result in different amounts in the flow of cash during certain periods in otherwise similar banks[190]. It is therefore difficult to distinguish between operational and financing activities. In addition, for some banks, raising funds from issuing equity or bonds may not be dissimilar to receiving deposits from customers.

5.8 Examples of investing activities that may not be part of a bank's revenue producing activity may the acquisition of a new office or the acquisition of another business.

5.9 With these issues in mind, it can therefore be questioned whether the statement of cash flows is useful for:

[187] Weiss & Yang (2007) distinguish between off-balance sheet transactions of a bank (such as fee-based activities), which do not result in special issues with the statement of cash flows for banks and transactions affecting the statement of financial position (such as lending money to customers) which create special issues with the statement of cash flows for banks.

[188] The fact that the business model of banks (and similar entities) is different from other types of entities is also reflected in IFRS 18. IFRS 18 provides specific requirements for the classification of dividends received, interest received, and interest paid for entities that invest in assets or provide financing to customers as a main business activity.

[189] Whether there would be a cash outflow, or a 'rebooking' will also depend on what is considered 'cash and cash equivalents'.

[190] Torfason (2014).

a) Understanding a bank's business (Objective 1a). As stated above, there is no 'cash conversion cycle' of banks which the statement of cash flows can reflect and which would be useful for understanding a bank's business. Also, as the distinction between operating, investing and financing activities may not be useful for banks, the categorisation of cash flows in the statement, may not add much value to understanding an entity's business. If operating cash flows are presented using the indirect method, the statement of cash flows could provide some information on changes in the sources of finance a bank is using. However, it is questionable whether the statement will provide much additional information than that available in the statement of financial position on this aspect. Also, this information will not appear if the statement of cash flows is prepared using the direct method of presenting cash flows from operating activities[191].

b) Assessing closeness to cash (Objective 1b.1). As there is no cash conversion feature related to most of banks' activities, the performance is not the main driver for changes in cash and cash equivalents of banks (at least in the short run) and as banks' access to cash likely less of an issue than for non-banks (for example because it can receive financing from securities eligible for refinance), the closeness of cash of a bank's earnings may often not be particularly relevant.

c) Assessing current performance of the entity (Objective 1b.2). As noted above, whether/when a transaction or action made by a bank affects 'cash and cash equivalents' can depend on the actions of the customer, the cash inflows and outflows of a bank in a period can be relatively arbitrary and may therefore not be useful for assessing the current performance.

d) Assessing the entity's financial structure (Objective 2). Liquidity assessments of banks are very important, and some are therefore of the view, that if there should be a purpose of the statement of cash flows for banks, it should be to assess liquidity. However, there may be, at least, two issues with this. Firstly, that the historical information provided in the statement of cash flows of banks may provide little information for assessing a banks' liquidity risk exposure. As the business model of many banks is to make short-term borrowing and long-term lending, the timing of future cash inflows and cash outflows is important information which is not presented in the statement of cash flows. Secondly, prudential regulation, designed to address liquidity issues of banks, use other characteristics to identify high quality liquid assets than how IAS 7 describes 'cash and cash equivalents'. This could indicate that 'cash and cash equivalents' as explained in IAS 7 is not the most relevant term to assess the liquidity of a bank. For the assessment of solvency, the argument has also been made that the solvency of a bank depends more on maintaining an adequate spread between the cost of funds and interest received than on adequate cash flows[192]. In addition, users need information on solvency on a daily basis, which financial reporting cannot provide[193].

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[191] Other mentioned issues with using the direct presentation of cash flows from operating activities include: The direct presentation will present a high volume of daily cash transactions controlled by customers (EFRAG 2015); it would be costly for preparers (EFRAG 2015 and BNP Paribas 2008); and it fails to meet the cohesiveness objective due to the weak relationship between operating assets and liabilities and operating income and expenses (Deutche Bank 2008 and U.S BankCorp 2008). However, as explained in paragraph 5.30, there could also be advantages of presenting cash flows from operating activities in accordance with the direct method.

[192] See paragraph 61 of the Basis for Conclusions (Appendix B) of the FASB standard FAS 95 (now superseded by ASC 230).

[193] Association of German Public Banks (2016).

e) Assessing the entity's ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities (Objective 3). For the same reasons as for why the statement of cash flows is not useful for assessing an entity's financial structure (Objective 2), the statement may also be of limited use to assess the agility of an entity.

f) Assessing the ability of the entity to generate cash and cash equivalents (Objective 4). As the cash flows of a bank are only marginally linked to the performance of the bank, the statement of cash flows may have little relevance when valuing a bank. The statement of cash flows may, however, provide information that can be relevant to consider for valuing a bank. For example, the statement of cash flows includes information on dividends paid. The statement of cash flows may on the other hand be less useful for assessing the amount of dividends a bank is able to pay. The amount of dividend a bank can pay is in the EU determined by other regulation and the amount a cash available for a bank is normally not an additional constraining factor as the bank is able to borrow money from central banks.

g) Comparing entities using different accounting treatments for the same transactions (Objective 5). As cash flows of a bank are only limited related to the performance of a bank, comparing banks using the statement of cash flows may not be particularly useful.

h) Assessing management's stewardship (Objective 6). As noted above in relation to Objective 1b.2, the statement of cash flows of a bank may not be useful for assessing the current performance of an entity. It therefore follows that it may also not be suitable for assessing the general performance of the management. The statement of cash flow can be used to assess changes in how a bank is financed and its lending/investment activities. However, as noted above in relation to Objective 1a, it is questionable whether the statement will provide much additional information to the information available in the statement of financial position on this aspect. For the assessment of the management's stewardship in ensuring that the bank will not run into liquidity issues in the future, the same issues as mentioned for Objective 2 apply.

5.10 In consultations prior to this DP, the input EFRAG has received from preparers is that the statement of cash flows is not useful. EFRAG has received mixed input from users. Some users have thus stated that, although they use the statement of cash flows for analysing non-financial entities, they do not use the statement of cash flows from banks. Similarly, the input received by the IASB and the FASB from both users and preparers of bank financial statements in response to the 2008 discussion paper *Preliminary Views on Financial Statement Presentation* indicated the statement of cash flows is not useful for banks[194]. Other users have stated that the statement of cash flows is useful, for example, when assessing dividends[195]. In addition, 60% of respondents commenting on a proposal in the IASB/FASB 2008 discussion paper *Preliminary Views of Financial Statement Presentation* considered that a developed direct presentation of cash flows communicated the relationship between an entity's cash flows and its assets, liabilities, income, expense, gains, and losses for the period 'well' or 'very well'[196].

[194] See paragraph 44 of IASB/FASB staff paper 7A for the IASB/FASB October 2009 meeting.
[195] Information collected at EFRAG round tables on the statement of cash flows.
[196] See paragraph 30 of IASB/FASB staff paper 7A for the IASB/FASB October 2009 meeting.

5.11 Similar input seems to have been provided to the FASB. Input collected by the FASB prior to its 2021 Agenda Consultation (FASB 2021a) showed that some investors questioned the relevance of the statement of cash flows for financial institutions. About half of the respondents to a FASB 2022 Investor Survey who follow financial institutions replied that they use the statement of cash flows in their analysis.

5.12 Academic literature on the usefulness of the statement of cash flows for banks is limited and the studies conducted have provided mixed results[197].

5.13 One study[198] (using US data) finds that banks' cash flows from operations are positively and significantly associated with share prices. It concludes that the findings suggest that banks' cash flows from operations provide useful information to investors in valuing banks' equity. However, the statement of cash flows is more value relevant for banks with a profit relative to those with a loss; for banks with higher Tier 1 capital ratios; and for banks with lower credit risk. Similarly, another study[199] finds that the operating cash flows of banks in Egypt and Lebanon (emerging and frontier markets) are value-relevant (positively correlated with share prices). A third study[200], considering two cases of banks with financial difficulties, assessed that the statement of cash flows is useful for understanding solvency and liquidity of banks (although some improvements to the statement are necessary).

5.14 In a fourth study[201], it is noted that banks can perform transactions that have no explicit current cash flow effect, but significantly impact operating cash flows reported in future periods. For instance, business combinations originate cash outflows presented as investing (or even no cash outflows, when the acquisition is paid in shares) but the financial assets of the acquiree generate operating cash flows; likewise, the purchase of some financial assets can be presented as investing outflows, but if these investments are transferred to a different category, their ultimate sale or redemption is presented as an operating cash flow. The study concluded that this may lead to questioning the relevance of the reported operating cash flows.

5.15 From interviews with bankers about the statement of cash flows in banks, a study[202] summarises that none of the interviewed persons use the statement of cash flows and have never been asked about it[203]. The author concludes that the findings indicate that the standard statement of cash flows does not work for banks because banks' operations are different from non-financial entities with respect to cash.

5.16 In this line, another study[204] finds that the incremental value relevance (beyond the statement of profit or loss and the statement of financial position) is limited (and is much less than that of non-financial entities). In addition, the statement of cash flows of banks has no distress-predictive power.

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[197] See, for example, Catanach (2000).

[198] Burke & Wieland (2017).

[199] Ragrab & El-Chaarani (2018).

[200] Klumpes et al. (2009).

[201] Mulford & Comiskey (2009).

[202] Torfason (2014).

[203] Similar input was received by ANC (2016).

[204] Gao et al. (2019).

5.17 Not assessing and using information from the statement of cash flows itself, a study[205] finds that cash flow variable only results in greater predictive accuracy of a model for bank failure in longer time horizon models. Another study[206], also not using information from the statement of cash flows, but estimating cash flows from operating activities, examines the usefulness of operating cash flows for distress predictions. The study finds that cash flows from operating activities reflect realised credit and interest rate risk in saving and loan industries. It also contributes incrementally to traditional thrift distress predictions in some years and reduces the risk of not classifying an entity in the industries as distressed, when it is distressed. However, it does not appear to improve the total prediction of the entities in the scope as distressed or not distressed for most of the distress prediction models examined in the study.

The usefulness of the statement of cash flows for insurance companies

5.18 For insurance companies, there are (at least) three factors that in combination result in the relevance of/additional information provided by the statement of cash flows being questionable (the second factor listed may be less relevant for some insurance companies only providing non-life insurance products compared with insurance companies (also) providing life-insurances):

a) The 'reverse' cash cycle under which the insurance company first receives cash and then subsequently incur the expenditures (for example, in the form of payments made in case of an insured event occurring). The 'reverse' cash cycle is, however, not unique to the insurance industry but incur in many non-financial industries as well, such as airline companies and in the entertainment industry. However, as a result of the reverse cash cycle, insurance companies are not prone to sudden withdrawals, as the policyholder premium payments generate consistent cash inflows. Therefore, the exposure of insurers to other risks rather than liquidity risk is what could make cash flow statements less relevant for users.

b) The inflows and outflows do, not take place in the same period. The business cycle of an insurance company is often (much) longer than a financial reporting year[207].

c) Some types of in- and outflows occur as occasional substantial remittances (e.g., payments related to certain weather conditions).

205 Henebry (1996).

206 Catanach (2000).

207 EFRAG (2015).

5.19 Cash flows from operating activities could accordingly resemble a revenue recognition principle under which revenue would be recognised when a contract with a customer would be agreed, but the entity's work of fulfilling the contract would only begin subsequently. The information could be used to assess the selling efforts of an insurance company but might otherwise not be useful for assessing its performance, including whether it has correctly assessed the risks it has insured so that it will have to pay out less than it has received (which is how an insurance company generally creates value). In these circumstances, the figures from the statement of cash flows may accordingly not be useful for assessing performance, and hence not be useful for: assessing the entity's business model (Objective 1a); assessing the current performance of the entity (Objective 1b.2); assessing the ability of the entity to generate cash and cash equivalents (Objective 4); comparing entities using different accounting treatments for the same transactions (Objective 5); and assessing the general performance of the management (Objective 6a). Although, the statement of cash flows may not be particularly useful for assessing the ability of an insurance company to generate cash and cash equivalents (Objective 4). Some users, do, however, consider that the statement can provide information on dividend payments and the ability of the insurance company to pay dividend.

5.20 As cash is received in advance and as cash flows are not a good measure of performance, assessing the closeness to cash (Objective 1b.1), may not seem particularly relevant for insurance companies.

5.21 The objectives of assessing the financial structure of an entity (Objective 2); assessing the ability to affect the amounts and timing of cash flows (Objective 3); and assessing management's cash management (Objective 6b), are relevant for insurance companies. In addition to generating profit from underwriting, insurance companies generate income from returns on investments they make from the cash received from customers. Some of these investments may not be easily sold and insurance companies could therefore be in a situation where they would have difficulties paying customers. The statement of cash flows can provide insights on whether an insurance company has had sufficient liquidity in the past, provide information to assess whether it in the short run will have sufficient liquidity. However, the statement may not provide much information about expected future cash out flows and whether at that point in time there will be sufficient cash.

5.22 Similar to banks, the statement of cash flows for an insurance company would provide information about the dividends paid in the past. This information, should, however, in the statement of changes in equity or disclosed in the notes following IFRS 18. Also, insurance companies may have many legal entities and cash generated in one entity cannot be transferred to another, due to prudential requirements, the group's statement of cash flows does (currently) not capture this particularity. Other information than the statement of cash flows may also be more useful for predicting future dividends (Objective 4).

5.23 In addition, similar to banks, the view has also been expressed that the categorisation of cash flows into investing, financing and operating activities, is not meaningful for insurance companies. This is mainly because the categories do not fully capture the particularities of the insurance business with the related activities, such as investing activities.

5.24 When the IASB and the FASB received feedback from both users and preparers of bank financial statements in response to the 2008 discussion paper *Preliminary Views on Financial Statement Presentation*, the input did not only indicate that the statement of cash flows is not useful for banks. It also indicated that it was not useful for other financial service entities such as insurance companies[208].

5.25 While EFRAG has also received mixed input on the relevance of the statement of cash flows for insurance companies, a few users have indicated that while they do not use the statement of cash flows for banks, they use it for insurance companies. Feedback revealed that there could be differences in the issues affecting the relevance of the statement of cash flows for entities only providing non-life insurance products compared with insurance companies that are (also) providing life insurance products.

Additional issues for financial institutions

5.26 As with non-financial institutions, there are issues for financial institutions on what should be considered 'cash and cash equivalents' to result in the most useful information. For a bank, it would thus, for example, be relevant to consider how demand deposits, securities eligible for refinancing and securities for trading should be considered[209]. The same applies to insurers, for example 'liquidity reserves', that are easily transferable financial instruments should be considered.

5.27 As noted in paragraph 5.7 categorisation of the cash flows of a bank is also an issue. In relation to classification, an issue is whether/when investing cash flows should include the purchase and sale of financial investments[211].

5.28 Similar to non-financial entities, some argue that there are also issues related to the level of detail of the information provided in statement of cash flows of banks[210]. For financial entities having different types of business (for example, both banking and insurance activities), one issue is thus that no segment information is provided. Such information might help users of financial statements to better understand how cash is generated and used under the two different activities[211].

5.29 Following input provided to EFRAG, some preparers consider that after the implementation of IFRS 17 *Insurance Contracts*, which may have distanced the performance reporting of insurance companies even further from 'cash accounting', it would be even more difficult for insurance companies to prepare a statement of cash flows in which cash flows from operating activities would be presented under the direct method.

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[208] See paragraph 44 of IASB/FASB staff paper 7A for the IASB/FASB October 2009 meeting.

[209] Input provided at the 24 June 2024 EAA, EFRAG and IASB research workshop Current and future research on Statement of Cash Flows and Related Matters. It was here, for example, argued, that it would not result in the most useful information to consider demand deposits as 'cash and cash equivalents'.

[210] Klumpes et al. (2009).

[211] ANC (2016) considers the statement of cash flows not being useful for financial institutions. It suggests that for proposed alternative information, segmental information should be linked with a disaggregation of the consolidated statement of financial position that would distinguish assets and liabilities arising from the different activities.

5.30 For banks, there are both arguments that the direct method of presenting cash flows from operating activities would not be useful (see e.g., paragraph 5.9a) above) and arguments that it would result in more useful information. An argument presented in favour of the direct method is that it would allow users to see the gross operating cash flows[212]. It would thus be possible to see the volume of gross lending flows which is valuable for understanding a bank's loan book and hence deterioration in credit quality as the loan book matures[213]. The statement of cash flows can be used alongside the statement of financial position. A gross presentation would also allow users of financial statements to calculate the bank's rate of liability turnover, which can be an important indicator of a bank's borrowing and therefore its need for cash [213]. A high liability turnover would thus indicate use of short-term fundings. However, as noted in paragraph 5.6 above, the repayment of a loan by a customer may not affect the cash position of a bank. Accordingly, for the suggested information to be available, it might be necessary to require cash flows that have not happened to be recorded[214].

Alternatives or improvements to the to the statement of cash flow for financial entities

5.31 Following the questionable usefulness of the statement of cash flows for financial entities, it could be considered to:

a) Remove the requirement for financial entities to prepare a statement of cash flows;

b) Replace the requirements for financial entities to prepare a statement of cash flows with alternative reporting requirements;

c) Introduce additional requirements for financial entities.

5.32 It could be argued that introducing additional requirements as stated in c) to compensate for the questionable relevant information resulting from the current statement of cash flows would not be an optimal solution from a cost/benefit perspective. If the usefulness of the statement of cash flows for financial institutions is very limited, which much input suggests it is, it may be argued that eliminating the requirement for these entities could achieve a better cost/benefit balance. Whether alternative requirements should be introduced would depend on, among other things, whether the information already provided elsewhere in the financial reports would be sufficient. If not, alternative information might have to be introduced.

5.33 Removing the requirements for financial entities to prepare a statement of cash flows or replacing the statement of cash flows are, however, not unproblematic. Firstly, the activities for which the statement of cash flows should not be prepared would have to be specified or defined. Secondly, it would have to be considered what entities/groups should do which would both have activities covered by the exception and activities for which a statement of cash flows should be prepared.

5.34 The next subsections explain the following alternative/additional requirements:

a) Presentation of regulatory ratios (for banks);

[212] A gross presentation of certain cash flows has also been suggested by, for example, EFRAG (2015) and DRSC (2016).
[213] Klumpes et al. (2009).

b) Information on liquidity (for banks and insurance companies);

c) Information about dividend payout capacity (for banks);

d) Presentation of statement of (regulatory) capital flows (for banks (and insurance companies));

e) Removal of categories (for banks and insurance companies);

f) Standardised table with stress-testing scenarios (for banks and insurance companies);

g) Information about the collection and uses of cash resources (for banks and insurance companies); and

h) Information on cash flows related to interests and loan originations and repayments (for banks).

5.35 These alternatives/additional requirements have been brought to the attention of EFRAG and should thus not be regarded as a complete list of alternatives/additional requirements. Also, EFRAG does not present a view as to whether these alternatives should be further pursued and whether they should be considered as alternatives to the statement of cash flows or additional requirements (not relevant for 5.34e)).

5.36 EFRAG does also not present a view on whether selecting one of the alternatives would necessarily be the best solution for all entities. Another approach could thus be to allow entities to select the alternative(s) they consider most beneficial for the users of their financial statements. The entities business model could thus be taken into account in the selection.

5.37 The alternatives/additional requirements listed in a), c) and d) provide information based on other frameworks with a different purpose than those of general-purpose financial reporting as stated in the Conceptual Framework. In addition to the practical issues related to introducing alternatives/additional requirements listed paragraph 5.32 above, an argument against providing the suggested information in the financial statements is that the information is prepared for another purpose, to support supervision, and it would be inappropriate and could result in confusion to require the information to be presented in the financial statements which have another objective[215]. The value of repeating the information that would be publicly available in other reports could anyway be expected to be minimal and financial reporting standards should not require information to be disclosed that can be provided to supervisory authorities on a confidential basis[216]. At the same time, the information provided for regulatory purposes could be 'consolidated' differently than the information included in the financial report and would thus not provide a faithful representation for the entities included in the consolidated financial statements[215] [216]. An issue of requiring information that would normally be placed in other reports than the financial statement relate to whether this information should then be audited or not. It could thus mean that information that is currently not subject to audit should be audited, or the financial statements should include unaudited information. Related to this, some disclosures would require forward-looking information and some therefore questions whether the financial statements are a suitable place to disclose this information. Also, it could be argued that some of the suggestions (e.g., a presentation of statement of regulatory capital) should be considered in relation to the statement of changes in equity rather than in relation to the statement of cash flows.

5.38 It could also be questioned whether the type of information suggested in b) and f) in paragraph 5.34 is related to cash flows information, or would be better placed and presented together with other disclosure requirements, for example, IFRS 7 *Financial Instruments: Disclosures*.

Regulatory ratios (for banks)

5.39 An alternative could be to replace the statement of cash flows with a requirement for banks to provide regulatory ratios as found in the risk management reports of banks[217]. This could, for example, be the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR). These are part of the Basel III agreements and provide information on the short-term resilience of the liquidity risk profile by banks, and the funding risk/founding stability respectively[218].

Information on liquidity (for banks and insurance companies)

5.40 As an alternative to providing regulatory ratios, a bank could also be required to provide information on liquidity. This could include[219]:

a) Information on highly liquid assets. The notion of cash and cash equivalents as defined by IAS 7 may not correspond to what commercial banks use to manage their liquidity. For liquidity management, banks focus on highly liquid assets for which the IAS 7 requirement for a short maturity and insignificant risk of changes in value may not be

[215] See, for example, Association of German Public Banks (2016).
[216] ANC (2016).
[217] Information collected at EFRAG round tables on the statement of cash flows.
[218] Basel Committee on Banking Supervision (2013).
[219] EFRAG (2015).

decisive. The LCR ratio (see paragraph 5.39 above) could be supplemented by information on the breakdown and changes in the stock of highly liquid assets.

b) Information on maturities. A ratio similar to the NFSR ratio (see paragraph 5.39 above) could be supplemented by a breakdown of contractual and/or expected maturities of financial asset and liabilities, prepared according to maturity buckets with sufficient sensitivity. An example is provided below in Illustration 7

Illustration 7. Example of a maturity table of assets, liabilities and off-balance sheet commitments

	Up to 1 month	1-6 months	6-12 months	1-2 years	2-5 years	Over 5 years	Unspecified maturity	Total
Cash and balances with central banks								
Interest-bearing securities eligible as collateral with central banks								
Bonds and other interest-bearing securities								
Loans to credit institutions								
of which reverse repos								
Loans to the public								
of which reverse repos								
Other								
of which shares and participating interests								
of which claims on investment banking settlements								
Total assets								
Due to credit institutions								
of which repos								
of which central banks								
Deposits and borrowing from the public								
of which repos								
Issued securities								
of which covered bonds								
of which certificates and other original maturity of less than one year								
of which senior bonds and other securities with original maturity of more than one year								
Subordinated liabilities								
Other								
of which short positions								
of which investment banking settlement debts								
Total liabilities								
Off-balance-sheet items								
Financial guarantees and unutilised commitments								

EFRAG (2015) p. 32

c) Information on encumbered assets. Assets which are potentially available for refinancing transactions by a bank (by pledging their assets as collateral) are referred to as unencumbered. Disclosures of encumbered and unencumbered assets by main category provide additional insight into the liquidity position. This information is currently required in the EU[220] (see Illustration 8). IFRS 7 already requires disclosure of the carrying amount of financial assets placed as collateral for liabilities or contingent liabilities. Similar information is required in other Standards for non-financial assets.

Illustration 8. Encumbered assets and collaterals

[220] EU 2021/451 of 17 December 2020.

F 32.01 — ASSETS OF THE REPORTING INSTITUTION (AE-ASS)											
		Carrying amount of encumbered assets			Fair value of encumbered assets		Carrying amount of non-encumbered assets			Fair value of non-encumbered assets	
			of which: issued by other entities of the group	of which: central bank's eligible		of which: central bank's eligible		of which: issued by other entities of the group	of which: central bank's eligible		of which: central bank's eligible
		010	020	030	040	050	060	070	080	090	100
010	**Assets of the reporting institution**										
020	Loans on demand										
030	Equity instruments										
040	Debt securities										
050	of which: covered bonds										
060	of which: asset-backed securities										
070	of which: issued by general governments										
080	of which: issued by financial corporations										
090	of which: issued by non-financial corporations										
100	Loans and advances other than loans on demand										
110	of which: mortgage loans										
120	Other assets										

F 32.02 — COLLATERAL RECEIVED (AE-COL)									
		Fair value of encumbered collateral received or own debt securities issued			Non-encumbered				
					Fair value of collateral received or own debt securities issued available for encumbrance			Nominal of collateral received or own debt securities issued non available for encumbrance
			of which: issued by other entities of the group	of which: central bank's eligible		of which: issued by other entities of the group	of which: central bank's eligible	
		010	020	030	040	050	060	070
130	**Collateral received by the reporting institution**							
140	Loans on demand							
150	Equity instruments							
160	Debt securities							
170	of which: covered bonds							
180	of which: asset-backed securities							
190	of which: issued by general governments							
200	of which: issued by financial corporations							
210	of which: issued by non-financial corporations							
220	Loans and advances other than loans on demand							
230	Other collateral received							
240	**Own debt securities issued other than own covered bonds or ABSs**							
250	**TOTAL ASSETS, COLLATERAL RECEIVED AND OWN DEBT SECURITIES ISSUED**							

Commission Implementing Regulation (EU) 2021/451 of 17 December 2020.

5.41 Instead of providing information on liquidity at a point in time, time-series information of a particular ratio could be provided (e.g. an encumbered asset ratio). Time series information might thus better reflect significant fluctuations within short periods of time of banks' liquidity[221].

[221] DRSC (2016).

5.42 A requirement to provide information on how liquidity needs are managed could also be introduced as well as a qualitative analysis of the components of the liquidity reserve held to meet those needs[222]. This would include maturity analysis taking into account behavioural assumptions (particularly on core deposits)[222]. This would be in addition to the current requirements on maturity analyses based on contractual maturities.

5.43 When considering information on liquidity, it should also be assessed whether this information should be provided at the level of legal entities, or the information could be useful if provided on a consolidated level[223].

5.44 Information on liquidity could also be considered for insurance companies. In addition to the information required in IFRS 7 (which is also relevant for banks), IFRS 17 includes additional requirements, which should be considered before developing additional requirement. Among other things, IFRS 17 requires insurance companies to provide maturity analyses of insurance and reinsurance contracts (an example is provided in Illustration 9).

Illustration 9. Example of maturity analysis of assets

37 Assets by contractual maturity

Amounts presented in these tables by contractual maturity are the amounts as presented in the balance sheet.

Assets by contractual maturity (2023)

2023	Less than 1 month[1]	1-3 months	3-12 months	1-5 years	Over 5 years	Maturity not applicable	Adjustment	Total
Cash and cash equivalents	7,981	225			1			8,207
Investments at fair value through OCI	1,722	2,053	4,895	18,409	79,570	3,451		110,100
Investments at cost	98	85	271	1,584	19,450			21,488
Investments at fair value through profit or loss[2]	963	5	108	252	167	47,897		49,392
Investments in real estate						2,620		2,620
Investments in associates and joint ventures						6,231		6,231
Derivatives	40	85	16	108	2,237			2,486
Insurance contracts	-9	11	49	202	258		-156	355
Reinsurance contracts	37	-25	145	561	345		-330	733
Property and equipment						348		348
Intangible assets	4	7	43	177	130	909		1,270
Deferred tax assets		38	6	38	54	10		146
Other assets	3,461	711	813	130	429	21		5,565
Total assets	**14,297**	**3,195**	**6,346**	**21,461**	**102,641**	**61,487**	**-486**	**208,941**

1 Includes assets on demand.

2 Includes Investments for risk of policyholders. Although individual Investments for risk of policyholders may (or may not) have a maturity depending on their nature, this does not impact the liquidity position of NN Group.

NN Group Annual Report 2023, page 275.

222 ANC (2016).

223 See also DRSC (2016).

Dividend payout capacity (for banks and insurance companies)

5.45 Considering that the statement of cash flows does not effectively provide information on dividend payout capacity of banks, an alternative approach would be to provide detailed disclosures that focus on current regulatory capital and future expectations, accompanying the statement of cash flows. Such disclosures would provide information on current regulatory capital levels, anticipated capital requirements and projections of future earnings. This approach acknowledges that liquidity is not a pressing issue for banks, as long as there is access to financing[224].

5.46 When the dividend payout capacity of insurance companies is regulated, this information could also be relevant for insurance companies. However, IFRS 17 requires entities to disclose information about the effect of regulatory frameworks in which they operate, and therefore it should be examined whether additional information is required.

Flow of regulatory capital (for banks (and insurance companies))

5.47 An exercise that some analysts perform is preparing a statement illustrating the flow of regulatory capital. These analysts consider such a statement to be more beneficial than a statement of cash flows because it provides a deeper understanding of the bank's capital adequacy and financial health. By tracking the movement of regulatory capital, analysts can assess whether the equity is growing at a pace sufficient to support the growth in the loan portfolio. Moreover, this alternative could reveal potential constraints on the bank's ability to expand its lending operations to ensure compliance with regulatory requirements[225]. An example is included in Illustration 10.

[224] Information collected at EFRAG round tables on the statement of cash flows.

[225] Information collected at EFRAG round tables on the statement of cash flows.

Illustration 10. Example of a flow statement for regulatory capital

	Year X	Year X-1
Core tier 1 (CET1) capital		
Opening amount	1,000	931
New capital issues	20	10
Redeemed capital	(10)	(15)
Gross dividends (deduction)	(21)	(16)
Shares issued in lieu of dividends (add back)	1	1
Profit for the year (attributable to shareholders of the parent company)	100	80
Removal of own credit spread (net of tax)	(40)	(14)
Movements in other comprehensive income	30	20
- Currency translation differences	10	10
- Available-for-sale investments	10	4
- Other	10	6
Goodwill and other intangible assets (deduction, net of related tax liability)	(5)	(5)
Other, including regulatory adjustments and transitional arrangements	25	8
- Deferred tax assets that rely on future profitability (excluding those arising from temporary differences)	10	2
- Prudential valuation adjustments	10	4
- Other	5	2
Closing amount	**1,100**	**1,000**
Other 'non-core' tier 1 (additional tier 1) capital		
Opening amount	295	300
New non-core tier 1 (Additional tier 1) eligible capital issues	5	30
Redeemed capital	(15)	(35)
Other, including regulatory adjustments and transitional arrangements	-	-
Closing amount	**285**	**295**
Total tier 1 capital	**1,385**	**1,295**
Tier 2 capital		
Opening amount	500	440
New tier 2 eligible capital issues	100	120
Redeemed capital	(20)	(15)
Amortisation adjustments	(15)	(35)
Other, including regulatory adjustments and transitional arrangements	(15)	(10)
Closing amount	**550**	**500**
Total regulatory capital	**1,935**	**1,795**

EFRAG (2015) p. 31.

5.48 Instead of providing a flow of regulatory capital, it could also be considered to present a reconciliation, or a qualitative explanation, of changes in highly liquid assets (see paragraph 5.40 above), or capital (not regulatory capital)[226]. Capital is considered by some to be a key indicator for solvency of banks. Reconciliation of the capital and information on flows would provide useful insights into the amount, structure and sources of growth in capital. Financial institutions may create internal buffers and target a higher level of capital than regulatory capital. Also, the amount of capital at a specific time may exceed the long-term target level. Therefore, the reconciliation should identify the portion of the regulatory, targeted and excess capital[226].

5.49 This approach could also be relevant for insurance companies for the same reasons as for banks.

Removal of categories (for banks and insurance companies)

5.50 As mentioned in paragraph 5.7, it is argued that the distinction between investing, financing and operating activities, which is a main element of the statement of cash flows, is not meaningful for banks. It is similarly noted in paragraph 5.23, that it may not be useful for insurance companies. Accordingly, the requirement to distinguish between these activities could be removed for these companies. While removing this requirement may reduce the cost of preparing the statement of cash flows for banks, it is questionable whether it would make the statement more useful.

Information about the collection and uses of cash resources (for banks and insurance companies)

5.51 For entities using cash as an underlying of the business, information about the collection of cash (distinguishing the different sources of funding) and how these resources have been allocated to financial assets could be provided[227]. This information could be used to assess how cash is managed. Information on the funding sources and uses of cash through the assets arising from operating activities and through the related funding resources should be distinguished from information on transactions that are outside operating activities (e.g., business combinations).

5.52 For banks, the information could include a description of the funding structure of the reporting entity, including key sources of funding (such as capital markets and equity, retail, wholesale secured funding and the like). The starting point could be a statement of funding sources and uses (Illustration 11 provides an example of such a statement). It could be supplemented with information on how the funding structure has changed in the accounting period.

[226] EFRAG (2015).

[227] The proposal on information collection and uses of cash resources was made by ANC (2016).

Illustration 11. Example of a sources of funding statement

Sources of funding

Our primary sources of funding are customer current accounts and savings deposits payable on demand or at short notice. We issue secured and unsecured wholesale securities to supplement customer deposits, meet regulatory obligations and to change the currency mix, maturity profile or location of our liabilities.

The following 'Funding sources' and 'Funding uses' tables provide a view of how our consolidated balance sheet is funded. In practice, all the principal operating entities are required to manage liquidity and funding risk on a stand-alone basis.

The tables analyse our consolidated balance sheet according to the assets that primarily arise from operating activities and the sources of funding primarily supporting these activities. Assets and liabilities that do not arise from operating activities are presented at a net balancing source or deployment of funds.

Funding sources

(Audited)

	2023	2022[1]
	$m	$m
Customer accounts	**1,611,647**	1,570,303
Deposits by banks	**73,163**	66,722
Repurchase agreements – non-trading	**172,100**	127,747
Debt securities in issue	**93,917**	78,149
Cash collateral, margin and settlement accounts	**85,255**	88,476
Liabilities of disposal groups held for sale[2]	**108,406**	114,597
Subordinated liabilities	**24,954**	22,290
Financial liabilities designated at fair value	**141,426**	127,321
Insurance contract liabilities	**120,851**	108,816
Trading liabilities	**73,150**	72,353
– repos	**12,198**	16,254
– stock lending	**3,322**	3,541
– other trading liabilities	**57,630**	52,558
Total equity	**192,610**	185,197
Other balance sheet liabilities	**341,198**	387,315
At 31 Dec	**3,038,677**	2,949,286

Funding uses

(Audited)

	2023	2022[1]
	$m	$m
Loans and advances to customers	**938,535**	923,561
Loans and advances to banks	**112,902**	104,475
Reverse repurchase agreements – non-trading	**252,217**	253,754
Cash collateral, margin and settlement accounts	**89,911**	82,984
Assets held for sale[2]	**114,134**	115,919
Trading assets	**289,159**	218,093
– reverse repos	**16,575**	14,798
– stock borrowing	**14,609**	10,706
– other trading assets	**257,975**	192,589
Financial investments	**442,763**	364,726
Cash and balances with central banks	**285,868**	327,002
Other balance sheet assets	**513,188**	558,772
At 31 Dec	**3,038,677**	2,949,286

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Standardised table with stress-testing scenarios (for banks and insurers)

5.53 For both banks and insurance companies, an alternative to the cash flow statement could involve providing a standardised table with stress-testing scenarios, for example reflecting interest rate shifts. This approach could provide comparable information on how interest rate movements impact liquidity[228]. However, it should be noted that relevant disclosures on liquidity are already provided under IFRS 7 and IFRS 17, and these should be considered before developing alternative reporting requirements[229].

5.54 For banks, it could be useful to simulate a scenario, where all customers withdraw all their funds known as a 'bank run scenario'[230]. By modelling this extreme situation, users can gain an insight into a bank's liquidity resilience[231]. Past events, such as the failure of Silicon Valley Bank, illustrate the consequences arising from massive withdrawals, which lead to a bank's failure. Therefore, this alternative could be a tool for providing users with insights into a bank's liquidity management[232].

5.55 It is important to note that FASB considered whether providing information about, for example, interest rate sensitivities and maturity schedules of loans and borrowings would be more useful than a statement of cash flows in assessing a bank's liquidity, financial flexibility, profitability and risk. The FASB noted that the information could potential be useful, but also noted that the assessment of liquidity, financial flexibility, profitability and risk anyway requires more information than just a statement of cash flows[233]. When assessing which additional/alternative information should be provided, it is thus important to consider all of the information that is currently provided, and not just the information provided in the statement of cash flows.

Information on cash flows related to interests and loan originations and repayments (for banks)

5.56 Banks are often considering cash flows from interest paid and received as well as cash flows from loan origination and repayments as operating activities in the statement of cash flows. When cash flows from operating activities are presented using the indirect method, these cash flows will accordingly not appear from the statement. As users find information on these cash flows useful[234], they could be provided when cash flows from operating activities are presented using the indirect method.

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[228] Information collected at EFRAG round tables on the statement of cash flows.

[229] Information collected at EFRAG round tables on the statement of cash flows.

[230] Warr (2023).

[231] Information collected at EFRAG round tables on the statement of cash flows.

[232] Information collected at EFRAG round tables on the statement of cash flows.

[233] See paragraph 62 of the Basis for Conclusions (Appendix B) of the FASB standard FAS 95 (1987) (now superseded by ASC 230).

[234] EFRAG (2015).

CHAPTER 6: TARGETED IMPROVEMENTS OR A COMPREHENSIVE REVIEW?

Many of the issues listed in Chapter 4 could be addressed by targeted improvements. It could thus be expected that some of the current issues could be addressed within a relatively short time horizon. Targeted improvements may, however, not solve more fundamental issues, and the question therefore arises whether fixing some issues or comprehensively reconsider the statement of cash flows (or something instead of a statement of cash flows) should be the way forward.

6.1 Chapter 4 listed the issues with the statement of cash flows that have currently been identified by EFRAG. In addition to these issues are the questions on whether a statement of cash flows should also be required by banks and insurance companies and whether generally, the statement of cash flows should be replaced by another statement.

6.2 Should the IASB, as part of its project on the statement of cash flows, decide not to replace the statement of cash flows, it would be possible to address many of the issues listed in Chapter 4 by targeted improvements. On some issues, such as the inclusion of non-cash transactions, targeted improvements may be more difficult and could likely involve considering what the purpose of the statement should be, which in turn, could result in a comprehensive revision of IAS 7. Even if the IASB would only amend IAS 7 to address some of the issues that could be dealt with by targeted improvements, a comprehensive review of the Standard could be beneficial to ensure consistency across the various requirements.

6.3 A comprehensive review would, however, likely take many years to complete and it could therefore be questioned whether targeted amendments that could result in some benefits in the short term would be preferable compared to having a potential better standard in many years. If so, the next question would be which issues it would be most important to solve. Differing views may exist on this, and some might therefore consider that any potential targeted improvements would not help much.

6.4 An alternative to either making targeted improvements or performing a comprehensive review would be to do both under a phased approach. Under such an approach, issues that could be addressed easily could be solved relatively fast while the bigger issues would await a comprehensive review. A potential problem with such an approach could, however, be that the amendments made in the first round of changes might have to be amended again once a comprehensive review of IAS 7 is performed. Frequent changes in the same requirements could be considered as a situation that should be avoided as it would result in costs for both preparers and users and not be beneficial.

APPENDIX 1: INPUT COLLECTED BY EFRAG

A1.1 The table below lists the meetings and events EFRAG arranged for the purpose of collected input for this DP.

A1.2 Table A1: List of meetings and events for collecting input for this DP:

Name of event	*Date*	*Place*
EFRAG Financial Institutions Roundtable	17 November 2023	Online
EFRAG Corporates Roundtable 1	27 November 2023	Online
EFRAG Additional Roundtable	30 November 2023	Online
EFRAG Users and Academics Roundtable	1 December 2023	Online
EFRAG Corporates Roundtable 2	4 December 2023	Online
EFRAG Valuators Outreach	7 February 2024	Online

A1.3 Input has also been collected during various EFRAG Working Groups, FR TEG and FRB meetings.

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