EFRAG proactive research project on the statement of cash flows

EFRAG FR TEG meeting 19 October 2023

Scope and preliminary feedback received

EFRAG
Financial reporting

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Objectives of EFRAG's project

- Identifying objectives of the statement of cash flows and identifying how the statement of cash flows is used.
- Identifying issues with how the statement of cash flows are currently prepared under the requirements in IAS 7.
- Discuss whether the IASB should address the issues identified by means of targeted improvements or a comprehensive revision of IAS 7.

Preliminary findings on the objective of the statement of cash flows

Different views heard from some European users:

- there is no primary objective for the statement of cash flows. It shows where an entity got its money from and what it did with the money;
- the objective is to explain why cash has not changed with the net profit of the period;
- the objective is to provide information on liquidity (specifically for insurance companies);
- the objective is to depict the ‘rhythm’ of the operating, investing and financing cash flows; and
- the objective is to offer a collection of information that can be used by users in their own analyses on e.g., credit worthiness (i.e., no purpose of the statement itself).

Preliminary findings on how the cash flows is used

Different uses heard from some European users:

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

Preliminary findings on issues with the statement of cash flows

Input from some European users:

- While the statement of cash flows is useful for insurance companies, it is not useful for banks.
- The statement of cash flows is prepared very differently from one entity to another. Comparability is an issue.
- Dividends to non-controlling interests are often included in the same figure as dividends to the entity's shareholders.
- Business combinations complicate the interpretation of the information in the statement of cash flows.
- It could be more useful to reconcile net debt (net financial obligation or net interest-bearing instruments or something similar).
- The usefulness for assessing liquidity could be improved (see also point on restrictions on cash below).
- Restrictions on cash are not sufficiently disclosed.
- Better information on liquidity would also involve better information on covenants.
- Although it is a statement of cash flows, some non-cash items like leases would be useful to have in the statement as an investment.
- Limited information and explanations in the notes.

- The indirect method to present cash flows from operating activities was generally considered most useful. Cases where the direct method can be most useful include when circumstances with significant business combinations. The direct method would also provide more granular information about the differences between operating cash flows and the related items in the statement of performance.

Preliminary findings on issues with the statement of cash flows

Input from EFRAG's Financial Instruments Working Group:

- Reconfirmed the conclusions included in EFRAG's feedback statement (published in 20216) on the input received in response to the EFRAG paper *The Statement of Cash Flows: Issues for Financial Institutions.*

Input from EFRAG's Insurance Accounting Working Group:

- Currently the statements of cash flows result in limited useful information for insurance companies.
- Reasons for why a useful statement of cash flows is needed:
  - Information on liquidity is important. Insurance companies could be illiquid but solvent. (Different views, however, on the importance of liquidity information and views were also expressed that information on liquidity could be better achieved through note disclosures).
  - It could provide information that could be used to test assumptions, for example in relation to CSM . (However, the view was also expressed that it was not the role of the statement of cash flows to provide that information.)
  - Information on how insurance companies generate cash – ultimately to pay dividends - was important. (However, it was also noted that users use earnings measures, and not cash flows, to obtain information for estimating future dividends.)
- Although, in general, the insurance sector faces similar issues to that of the banking industry, concerning the usefulness of the cash flow statement, there are differences between insurers and banks related to the business model and cash flow generation.

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