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

Cover Note

Objective

- 1 The objectives of the session are:
 - (a) To introduce the contractor (Zielke Research Consult GmbH) that will assist EFRAG on its proactive research project on cash flow reporting and set expectations on the delivery of the outsourced work.
 - (b) To present the initial feedback collected on the objectives/uses of and the issues with the statement of cash flows.
 - (c) To collect EFRAG FR TEG's additional inputs on the objectives/uses of and the issues with the statement of cash flows.
 - (d) To confirm the outreach approach of the first phase of the Discussion Paper.

Background

- 2 Following the 2021 consultation on EFRAG's research agenda, EFRAG decided in June 2022 to include on its research agenda a project on the statement of cash flows (see EFRAG [feedback statement](#)).
- 3 The reasons for adding this project to the EFRAG proactive agenda were that:
 - (a) the project could be useful for the IASB since the IASB has also decided to include a project on the statement of cash flows and related matters as research pipeline projects following its Request for Information (RfI) on its Third Agenda Consultation; and
 - (b) the project could encompass supply financing arrangements, which was deemed as a suitable EFRAG proactive project.
- 4 Therefore, in June 2023 EFRAG FR TEG considered the scope of the project which would be most useful for the IASB's work on the statement of cash flows if that project:
 - (a) lists and briefly discusses different alternative objectives/uses of the statement of cash flows. This will include considering whether the statement should reflect changes in cash, changes in cash and cash equivalents, or changes in working capital or net debt;
 - (b) lists the issues with current requirements/practice. The issues would be categorised/labelled according to which use/object of the statement of cash flows (in (a)) they would be related to;

- (c) discusses whether the IASB could consider the issues by targeted amendments, or a comprehensive review would be necessary to deal with the issues in a satisfactory manner.
- 5 Although the IASB has not yet assigned staff to its project on the statement of cash flows, the EFRAG Secretariat has consulted a member of the IASB technical staff, to which the EFRAG Secretariat was directed, on the type of EFRAG project that could be most useful for the IASB. The member of the IASB technical staff viewed the tasks listed in paragraph 4(a) and 4(b) as the most useful (among a list of alternatives).
- 6 In addition, the EFRAG Secretariat was informed (by EFRAG Working Groups, Panels, FR TEG, FRB) that there were particular issues with the usefulness of the statement of cash flows for financial institutions that would need specific consideration and would therefore be listed separately.
- 7 In its June 2023 meeting, EFRAG FRB approved the scope and agreed to outsource some of the project's parts (listed in paragraph 4(a) - 4(b)). In addition, EFRAG FRB highlighted that the project should focus on the fundamental issues as this was considered to be most useful for the IASB.
- 8 On 8 September 2023, EFRAG issued an open call for tenders to assist EFRAG in identifying uses of and issues with the statement of cash flows. EFRAG seeks input for EFRAG's Discussion Paper in identifying objectives of and uses and issues with how the statement of cash flows is currently prepared. As a first step, the contractor is requested to summarise its input to the part of EFRAG's Discussion Paper on the objectives of the statement of cash flows and how the statement of cash flows is used (to be finalised end of January 2024). Based on this, the contractor will work on the issues with the preparation of statements of cash flows in practice (second part of the report to be finalised in April 2024).
- 9 The contractor's report should be written and structured in a way that is most useful for the publication of EFRAG's Discussion. Therefore, the EFRAG Secretariat seeks EFRAG FR TEG's input on the structure and on the emphasis of the contractor's work, which will be discussed in this meeting.

Initial feedback received

- 10 Thus far, EFRAG has collected initial feedback on the objectives/uses of and the issues with the statement of cash flows, which can be found in the **Appendix** of this cover note.
- 11 The initial feedback and the additional inputs received during this meeting will be considered by the contractor when conducting the work.

Timeline and scope of the outsourcing of work

- 12 The milestones of the outsourced work are listed below:
 - (a) 19 October 2023: Input from EFRAG FR TEG will be collected by the contractor.
 - (b) October-December 2023: Input from literature, interviews, roundtables organised by the EFRAG Secretariat will be collected by the contractor.
 - (c) 11 December 2023: The first draft of the first part of the report on objectives/uses of the statement of cash flows will be submitted to EFRAG by the contractor.
 - (d) 19 December 2023: Input from EFRAG FR TEG and EFRAG FRB on the first part of the report will be collected by the contractor.

Scope of EFRAG's proactive project on the statement of cash flows and related matters – Cover Note

- (e) 30 January 2024: The final version of the first part of the report will be submitted to EFRAG by the contractor.
 - (f) February-March 2024: Input from literature, IFRS Interpretations Committee, accounting manuals, and interviews will be collected by the contractor.
 - (g) 20 March 2023: The draft of the second part of the report on issues with the statement of cash flows will be submitted to EFRAG by the contractor.
 - (h) 28 March-4 April 2024: Review and revision of the second part of the report.
 - (i) W/c 15 April 2024: Input from EFRAG FR TEG and EFRAG FRB on the second part of the report will be collected by the contractor.
 - (j) 3 May 2024: The final version of the report will be submitted to EFRAG by the contractor.
- 13 A more detailed overview of the different phases of the project, including deliverables and timelines, can be found in the [open call for tender](#) (part A.3.1), as issued by EFRAG.

Next steps

Outreach

- 14 The EFRAG Secretariat will organise roundtables and a user panel meeting to collect input to the contractor's reports and its Discussion Paper from the users' and preparers' perspective. Roundtables are intended to be organised for corporates and for financial institutions separately. Users are requested to provide their input.
- 15 The contractor will organise additional interviews with relevant persons to obtain information about the uses of statements of cash flows in practice.
- 16 The topic will be discussed with EFRAG's Academic Panel in its 31 October 2023 meeting.

Contractor's report

- 17 The first draft of the report on input for EFRAG's Discussion Paper on the objectives of the statement of cash flows and how the statement of cash flows is used will be submitted to EFRAG FR TEG and will be discussed in the December 2023 EFRAG FR TEG-FRB joint meeting.
- 18 The EFRAG Secretariat will ensure the on-going information exchange with the contractor and will be reviewing the progress of the report.

Agenda papers

- 19 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 01-02 – Presentation - *EFRAG proactive research project on the statement of cash flows – Scope and preliminary feedback received*

Questions for EFRAG FR TEG

- 20 Does EFRAG FR TEG have additional feedback/inputs on top of the preliminary findings, which can be found in the Appendix of this cover note?
- 21 Does EFRAG FR TEG have any input to provide to the contractor on relevant literature that can be used for the project?
- 22 As it appears in paragraph 7, the EFRAG FRB considered that focusing on the fundamental issues would be most useful for the IASB. The IASB has, however, subsequently informed the EFRAG Secretariat, that a comprehensive list of issues would be most useful. With this in mind, would EFRAG FR TEG consider recommending the EFRAG FRB to include a comprehensive list of issues in the Discussion Paper, but focusing the description on the fundamental issues?
- 23 EFRAG has previously considered the usefulness of the statement of cash flows for financial institutions and these findings have been confirmed by the FIWG for banks). The usefulness of the statement of cash flows for banks and insurance companies is different according to initial input received (and the usefulness could be different for life and non-life insurance companies). Does EFRAG FR TEG have other directions for the contractor could also be useful to include? Regarding the intended outreach in Q4 2023, are there any other industry specific issues to be addressed besides the ones of financial institutions? Is there a need to reach out to other industries to properly reflect their issues in EFRAG's Discussion Paper?
- 24 As outlined in paragraph 9, the EFRAG Secretariat seeks EFRAG FR TEG's inputs on how the contractor's report should be structured and on which points to focus on, so that it is most useful for EFRAG's Discussion Paper. Does EFRAG FR TEG have any input to provide on the topic?

Appendix – summary of past discussions

Previous EFRAG FR TEG and User Panel discussions

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

- 1 During the meeting EFRAG User Panel members provided input on what improvements could be made to IAS 7 Statement of Cash Flows by considering:
 - (a) how to improve the usefulness of the statement of cash flows (what should be the purpose of the statement of cash flows);
 - (b) how users (currently) use the statement of cash flows; and
 - (c) what issues users encounter with how statements of cash flows are currently prepared/the current requirements.

Objective of the statement of cash flows

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

How the statement of cash flows is used

- 4 The following uses of the statement of cash flows were provided by users:
 - (a) to assess management's stewardship — how the management is dealing with the cash the entity is generating (CapEx policies, capital policies, what is financed, impact on statement of financial position, free cash flow generated compared to invested capital);
 - (b) to help reconcile movements in net debt (e.g., what is repayments and what is interest) to calculate cash yield numbers);
 - (c) to help reconcile cash movements;
 - (d) to assess liquidity;
 - (e) to understand working capital dynamics (e.g., how much working capital is absorbed as the entity grows);

- (f) to compare CapEx with depreciations (to assess whether entities are growing – and for corrections to discounted cash flows projections). It is used to assess what profit is realised (and not e.g., changes in fair values); and
- (g) it is currently not used much for banks.

Issues with the statement of cash flows

5 The following issues were mentioned by users:

- (a) while the statement of cash flows is useful for insurance companies, it is not useful for banks;
- (b) the statement of cash flows is prepared very differently from one entity to another. Comparability is an issue;
- (c) dividends to non-controlling interests are often included in the same figure as dividends to the entity's shareholders;
- (d) business combinations complicate the interpretation of the information in the statement of cash flows;
- (e) it could be more useful to reconcile net debt (net financial obligation or net interest-bearing instruments or something similar);
- (f) the usefulness for assessing liquidity could be improved (see also point on restrictions on cash);
- (g) restrictions on cash are not sufficiently disclosed;
- (h) better information on liquidity would also involve better information on covenants;
- (i) it might not be possible/useful to achieve 'cohesiveness' with the labelling in the statement of financial performance. For example, operating income is after depreciations, but cash flows from operating activities is before CapEx - and analysts did not want to change that;
- (j) although it is a statement of cash flows, some non-cash items like leases would be useful to have in the statement as an investment;
- (k) the indirect method to present cash flows from operating activities was generally most useful. Cases where the direct method was most useful included when there were significant business combinations. The direct method would also provide more granular information about the differences between operating cash flows and the related items in the statement of performance; and
- (l) the few disclosure requirements lead to limited information and explanations in the notes.

6 The following issues were mentioned by non-users:

- (a) there are different views on what 'cash equivalents' consist of - it raises the question of whether it is more appropriate to only include 'cash' in the statement;
- (b) in relation to whether a transaction would be a non-cash transaction or not, agent/principal relationships should be taken into account;
- (c) it is difficult to compare the statement of cash flows between entities as the statements are prepared in different manners (e.g., different layouts and different manners to categorise cash flows);
- (d) IAS 7 is an old standard that does not reflect the type of transactions that occur today; and

- (e) the preference for the direct or indirect method to present cash flows from operating activities could depend on the user's background.

Issues previously addressed in EFRAG Comment Letters

- 7 EFRAG addressed issues with the cash flow reporting in its comment letter for the IASB projects [Supplier Finance Arrangements](#) and [Primary Financial Statements](#).

IASB Background

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