

# IAS 7 - STATEMENT OF CASH FLOWS IS OLD. IS IT STILL FIT?

## SUMMARY REPORT

EAA CONGRESS – 17 MAY 2024



This report has been prepared for the convenience of European constituents by the EFRAG Secretariat and has not been subject to review or discussion by neither the EFRAGFRB nor the EFRAG FRTEG. It has been reviewed by the speakers at the event.

## Background / Introduction

On 17 May 2024, at the 46th Annual Congress of the European Accounting Association (EAA) in Romania, EFRAG hosted a symposium on the statement of cash flows.

EFRAG CEO Saskia Slomp welcomed participants. To introduce the session, the EFRAG Financial Reporting TEG Chair Sébastien Harushimana gave an overview of the objective and status of EFRAG's proactive project on the statement of cash flows.

Following the introduction, Mark Clatworthy (EAA President and professor at the University of Bristol) moderated a panel discussion involving the following panellists:

- Tina Aggerholm, Danish Industry
- Martijn Bos, policy advisor Reporting & Audit at Eumedion
- Malgorzata Matusiewicz, EFRAG FR TEG member, EY Poland partner
- Rasmus Sommer, EFRAG Associate Director
- Ann Tarca, IASB member.

The panellists discussed the following issues related to the statement of cash flows:

- Is the statement of cash flows useful?
- Is 'cash' still special?
- What is in need of repair?
- What are the next steps and how can academics be helpful?

The panel debate was followed by a Q&A session.

The views expressed by the speakers and panellists during the event were personal views and do not necessarily represent the views of the organisations or entities they were associated with.

## State of EFRAG's proactive project on the statement of cash flows



**Sébastien Harushimana** informed that EFRAG undertook the project on the statement of cash flows as a result of its latest agenda consultation on its proactive research activities. In addition to commenting on the IASB's consultation documents and providing endorsement advice on IFRS Accounting Standards and Interpretations, EFRAG also has an obligation to carry out proactive activities with the aim of providing 'early stage' work.

To decide on which projects EFRAG should do proactive work, EFRAG consults from time to time on its proactive work plan. Last time was when EFRAG also consulted on the input that EFRAG should provide in response to the IASB's Third Agenda Consultation. Based on the input received, EFRAG chose to initiate a project on the statement of cash flows for the following reasons:

- firstly because the IASB decided to include a project on the statement of cash flows in its pipeline. An EFRAG project on the statement of cash flows could therefore be contributing, from a European perspective, to the IASB's work and thus have an impact in the near future; and
- secondly because it presented an opportunity for considering some issues related to supplier finance arrangements. A project on supplier finance was one of the projects that received most support in the agenda consultation.

In order to contribute to the IASB in an effective and pragmatic way, the main purpose of EFRAG's project is to list the issues that currently exist with the statement of cash flows as prepared in accordance with IAS 7 *Statement of Cash Flows*. Providing an inventory of these issues would, among other things, provide input to the IASB on when it has to decide on the scope, nature and extent of its project on the statement of cash flows. Although the IASB has decided that it will soon start a project on the statement of cash flows, it has not yet decided the scope of that project. However, what is considered to be an issue could depend on what the statement of cash flows is used for. The discussion paper will therefore first examine what the objectives of the statement of cash flows are and how the statement is used.

## Panel discussion

### Is the statement of cash flows useful?



**Mark Clatworthy** started the panel discussion by referring to an article written by the Chief Accountant of the SEC Paul Munter. In the article, Paul Munter states: 'Unfortunately, we have observed that preparers and auditors may not always apply the same rigor and attention to the statement of cash flows as they do to other financial statements, which may impede high quality financial reporting for the benefits of investors. This is evidenced

by the statement of cash flows consistently being a leading area of financial statement restatements and by our observations of material weaknesses in internal control over financial reporting around the preparation and presentation of the statement of cash flows'.



**Tina Aggerholm** thought that the fact that IAS 7 had not been updated significantly since it was issued was a cause of the current issues with the Standard. She noted the traditions on how to prepare the statement of cash flows in the US and in Europe. In Europe, entities generally prepared the statement of cash flows based on very detailed information, so cash flows were, for example, not just based on changes of assets and liabilities at the group

level. Instead, the bookkeeping captured different types of changes in the relevant assets and liabilities. For example, for trade receivables the bookkeeping would distinguish between 'normal cash settlements' of trade receivables, losses on trade receivables and other types of settlements than cash settlements. Also, in a multinational company, the information would be collected in local currencies before being translated into the presentation currency. Accordingly, she did not share the views expressed by Paul Munter in a European context.

However, she acknowledged that for outsiders it could seem as if the statement of cash flows had not been prepared using the same rigor and attention as when preparing other financial statements because the statement was so 'old fashioned' compared with other statements.



**Martijn Bos** explained that the statement of cash flows is one of the three key pieces of the annual accounts puzzle. The other two pieces are the statement of profit or loss and the statement of the financial position. With just the other two pieces you could still get an idea of what the last cash flow piece would look like, but you would forego key insights.

He considered the statement of cash flows to be important. It provides another perspective on the information already provided in the statement of financial position and the statement of profit or loss. A company cannot pay dividends or repay its creditors with just a sizeable profit; it needs cash. Cash for an entity is like the blood in the veins of a human being. The prospect of future cash distributions by the entity is what analysts base their valuation on. It is therefore important for analysts to get information on cash flows in addition to the performance of an entity.



**Rasmus Sommer** explained that the input EFRAG had collected on the use of the statement of cash flows indicated that the statement was used together with the other information in the financial statements. However, the usage of the statement varied significantly from user to user. Some users barely use the statement of cash flows or, for example, only use the information on capital expenditures for their projections of future cash flows. They

mainly use the statement of profit or loss and the statement of financial position for the projections of future cash flows. Other users consider that the financial statements would be incomplete without a statement of cash flows.



**Malgorzata Matusewicz** considered the statement of cash flows to be an important statement, and also because cash by nature is a very liquid asset, it was considered an important element of an audit. Some errors in the statement of cash flows were related to weaknesses or errors in internal control systems. However, there were also weaknesses in IAS 7 which continuously resulted in discussions. These discussions related to, *inter alia*,

the differentiation between cash and cash equivalents and other liquid assets, categorisation (cash flows from operating, investing or financing activities), disclosures and non-cash transactions.



**Ann Tarca** explained that the IASB had included a project on the statement of cash flows in its research pipeline as a result of its Third Agenda Consultation. Constituents had pointed to a long list of issues with the statement of cash flows, for example issues related to non-cash transactions, which had come up as a result of changes to lease accounting and changes in the economic environment such as the introduction of supplier finance arrangements and greater use of share-based payments. There were also still questions on how to classify cash

flows into operating, investing and financing activities and questions around disclosures, for example in relation to more disaggregated information, as people were looking for more information behind the numbers reported in the statement. Thus, there was a demand for learning more about capital expenditures used for maintenance, growth and acquisitions. Some of the feedback had also asked for the IASB to either remove the requirement to prepare a statement of cash flows for financial institutions or make the statement more useful for those entities.

## Is 'cash' still special?

**Mark Clatworthy** asked whether it was still relevant to prepare a statement of cash flows, whether it is clear what cash and cash equivalent are and whether another type of statement would be more relevant.

**Malgorzata Matusewicz** considered that in practice it was very challenging to determine whether something should be considered as 'cash and cash equivalents'. Also, the requirements could be considered very rules-based. For example, IAS 7 mentions that 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. Finally, the manner in which IAS 7 describes cash and cash equivalents is seldom aligned with how the management of an entity manages liquidity. For example, there were differing views on whether, in a high-interest environment, an entity could classify a six-month deposit as cash equivalents when it could get the money by paying a penalty. If such term deposits could not be considered 'cash equivalents', it could affect the decisions of managers on whether to place money on such deposit accounts. She thought it should be considered either only to include 'cash' (and not cash equivalents) in the statement of cash flows or to include a statement showing separately movements in 'cash' and 'cash equivalents and other highly liquid assets used for liquidity management purposes'.

**Martijn Bos** agreed with Malgorzata Matusewicz that the diversity in practice on what is considered 'cash and cash equivalents' should be addressed. He highlighted that users of financial statements would not be interested in having too broad a definition of 'cash and cash equivalents'. It should be defined in a tight manner. An entity could consider a two-years term deposit when managing its liquidity; however, such an investment might not be available to service the entity's short-term debt, and users are interested in assessing whether the cash position of an entity can be used to service maturing debt. That did not mean that investors would not appreciate an entity placing its cash in such deposits, but it was an investing activity and should be depicted as such in the statement of cash flows. He is therefore not supportive of opening the 'three-month' rule in IAS 7.

**Martijn Bos** stated that there was insufficient information about restrictions on cash in the statement of cash flows. A group could report a high amount of cash, but the entire amount might not be available to service debt in the parent company because the reported consolidated cash could be held in a subsidiary in which the parent entity only holds, for example, a 60% interest. Also, IFRS financial statements do not provide information on, for example, repatriation taxes that would have to be paid if, for example, the cash of a subsidiary would have to be transferred to the parent entity. There could also be other limitations or uncertainties related to the parent entity's possibilities of having cash transferred from subsidiaries in certain jurisdictions.

**Tina Aggerholm** agreed with Martijn Bos. She noted that some companies provided additional voluntary disclosures on possible issues that could arise in relation to transferring cash among group entities. Also, information on unused drawing rights and the related terms for the various jurisdictions in which subsidiaries were held was considered useful information. She thought it was important to decide what the statement of cash flows should depict. It should be considered whether the statement should only show movements in 'cash and cash equivalents', liquidity, funding or whether the statement should also show movements in non-cash items and available drawing rights. She thought it was important to understand what users needed the statement for. It was her experience that users were particularly interested in understanding two things, the first being the cash conversion, that is, how fast would earnings be converted into cash, the second being understanding other types of settlements that are not directly related to the statement of cash flows. This includes how leases are considered by an entity and share-based payments. She noted that many users do not understand the link between the statement of profit or loss, the statement of financial position and the statement of cash flows with regard to leases. Also, users had problems with share-based payments, for example, related to acquisitions. These issues also involved understanding the possible future payments that might have to be made for a past acquisition of a business.

**Martijn Bos** noted in relation to share-based payments that if an entity would pay for another business by means of shares, nothing would be included in the statement of cash flows. On the other hand, if an entity would first sell own shares and then use the cash for the payment, the acquisition would be reflected in the statement of cash flows. He thought that the cash flow statement should be more informative in this respect. In the first example, the acquisition should be reflected as if the transaction had been effectuated in cash with the proceeds received from selling own shares.

**Malgorzata Matusewicz** considered a related issue on which there was no guidance in IAS 7. The issue was whether the cash flows of a party acting as an agent for an entity should be included in the statement of cash flows of the entity. She thought that if only the transactions of the entity itself were included in the statement of cash flows, the statement would not appropriately reflect the transaction. For example, in a supplier finance arrangement a bank would pay a supplier on behalf of an entity. The bank would pay the supplier according to the terms stated in the invoice, and the entity could then pay the bank at a later date. Some considered that the payment of the bank to the supplier should be reflected in the statement of cash flows of the entity which would also receive a financing cash inflow. Others would only reflect the payment of the entity to the bank in the entity's statement of cash flows as they would argue the entity had not made any payments to the supplier. She thought that it should be considered who directed the payment, controlled the timing and the amount and who benefitted from the arrangement when assessing how to account for the transaction. For example, if the bank only made the payment because the entity did not have a bank account in a particular jurisdiction, this could indicate that the entity should include the payment to the supplier in its statement of cash flows.

**Ann Tarca** explained that the IASB would start its project on the statement of cash flows in Q3 2024. The IASB would start by considering all types of input such as the input that would be provided by EFRAG's proactive project, projects of other national standard setters and academic literature. Based on this input, the IASB would then decide on the scope of its project. It would also have to be considered whether a comprehensive project, that would take many years, should be initiated or whether the IASB should instead make targeted improvements, for example, on what should be considered 'cash and cash equivalents' and some other aspects.

### **What is in need of repair?**

**Mark Clatworthy** asked panellists what the issues are with how the statement of cash flows is currently prepared following the requirements in IAS 7 and whether it would be possible/advisable to fix the issues with targeted improvements or by means of a comprehensive review.

**Malgorzata Matusiewicz** considered that before deciding on the scope of the IASB's project, a discussion was needed on the purpose of the statement of cash flows. The IASB should address the issues related to:

- what cash and cash equivalents are;
- categorisation issues. Here the issue is that there is no clear guidance on how to classify certain cash flows and that some cash flows are not classified in an appropriate manner, for example transactions involving deferred payments (it should be discussed whether the related cash flows would be operating cash flows, financing cash flows or a mix), cash receipts from government grants and cash flows related to derivatives (particularly those that are used for hedging but have not been designated as such);
- consistency in classification in the statement of financial position and the statement of cash flows. This includes the classification of payments of payables using reverse factoring arrangements. These liabilities may not be presented as trade payables but as finance payables. It is unclear whether the payments should therefore be reflected as payments of the supplier or as financing activities because the payment is to a bank;
- the usefulness of the statement of cash flows for financial institutions; and
- disclosures.

**Martijn Bos** considered that the timing was right to discuss improvements to IAS 7 as much relevant work, for example in relation to aggregation/disaggregation and classification, had been done in relation to IFRS 18. He thought it was important to consider what could be done within a reasonable timeframe. He considered that a project that could deal with 80-85% of the issues within a limited time was preferable to a project that would aim at addressing all issues but would take many years to complete. In relation to the IFRS 18 project, he noted that there had been long discussions about how to define unusual and non-recurring items. However, it had not been possible to agree on such definition. There were potentially similar issues in relation to the statement of cash flows. He was aware that some users asked for capital expenditures to be divided between those relating to maintenance and those relating to growth. However, he expected that an attempt by the IASB to try to distinguish between these types of expenditures would also result in long unfruitful discussions. He therefore recommended the IASB not to endeavour in this direction as it could delay the project.

**Tina Aggerholm** noted that it was difficult for entities to explain to users why reported cash flows are different from what users could expect based on the statement of profit or loss and the changes in the financial position of an entity. It would become even more complicated in the future with the differences in the categorisation used in the statement of profit or loss following IFRS 18 *Presentation and Disclosure in Financial Statements* and the categorisation in the statement of cash flows following IAS 7. She considered that many things were broken in IAS 7. However, there were some issues that were more urgent to fix than others. A quick fix of these urgent issues, which include alignment with the categorisation as per IFRS 18 and better disclosures to help users understand the liquidity position of an entity, was therefore essential. Then, issues related to whether non-cash transactions should be included in the statement of cash flows could be considered at a later stage.

**Ann Tarca** noted that the IFRS 18 project had taken more than 10 years to complete. That project had even been narrowed down to not look at the statement of cash flows in order to be able to provide improvements to the statement of financial position and statement of profit or loss that investors wanted to see. She acknowledged that to make improved information, categories had been created that were not defined in the same manner as in IAS 7.

In the past, the IASB had had many discussions on the alignment of financial statements; however, this work has been paused.

The IASB was aware that some people wanted to see some quick fixes on the statement of cash flows. Accordingly, the IASB was interested in knowing what the potential quick fixes could be.

**Malgorzata Matusewicz** recommended the IASB to be as clear as possible in its communications about the needs of users and issues of preparers when developing the project on the statement of cash flows as it had been on the project resulting in IFRS 18. On the alignment with the categorisation used in the statement of profit or loss and the statement of cash flows, she noted that full alignment would mean that capital expenditures should be presented within the operating activities in the statement of cash flows. She was unsure as to whether that would be accepted. She also noted that the IASB's project on intangibles could have implications for how cash flows should be categorised in the statement of cash flows if the IASB maintained the requirement that only expenditures that were capitalised could be included in the investment category. This currently affected how some expenditures related to software projects should be categorised. She was not sure that the current information on expenditures on software (as a service) was considered relevant by users.

### **What are the next steps and how can academics be helpful?**

**Mark Clatworthy** asked how academics could be helpful in the process of amending IAS 7.

**Martijn Bos** replied that academics could examine current diversity in practice. Also, academics could try to develop principles on which non-cash transactions should be included in the statement of cash flows and which should not.

**Mark Clatworthy** asked how users use the statement of cash flows, particularly whether they use the statement as presented or whether they select pieces of information from the statement.

**Martijn Bos** replied that it was very normal for users to adjust the figures presented in the financial statements, including those reported in the statement of cash flows. He noted that a categorisation into operating, investing and financing activity similar to that of IFRS 18 in the statement of cash flows would be helpful for users in making their adjustments; however, full alignment is not desirable as most analysts would agree that cash flows from operations are before deduction of capital expenditures and operating profit is rightfully defined as after its sibling depreciation.

**Tina Aggerholm** considered it could be useful if academics could investigate the information users want from the statement of cash flows. She noted Martijn Bos's remark that users start from operating profit and asked whether the information users want from the statement of cash flows is then how to transform short-term earnings, as depicted in the statement of profit or loss, to long-term predictions, or whether users want information about short-term liquidity to form expectations about long-term financing. If there were two different objectives, it could be considered whether one statement or different types of information would be most useful. Knowledge about the needs of users would not only be useful for standard setters but also for preparers as the latter did not want to spend a lot of resources on preparing information that would not be used and further be asked by users to prepare additional information.

**Martijn Bos** replied that sometimes it was considered that the wishes of debt investors were very different from those of equity investors. He considered that often the objectives were quite similar. When he had been a debt investor, they had been very cash-flow-oriented as entities do need to refinance debt. If an entity needed to refinance in six years, debt investors needed to estimate the cash flows in and beyond those six years to assess whether the entity would be able to refinance the debt upon maturity.

**Martijn Bos** also wanted to address another issue: the presentation of cash flows from operating activities using the direct or indirect method. He noted that there were some advantages to the indirect presentation of cash flows from operating activities. The indirect method explained why the cash balance had not changed with the same amount as income. That information was very useful. An advantage of the indirect method was also that small numbers indicate minor issues whereas big figures indicate potential big issues. On the contrary, the direct method would start by showing the cash and cash equivalents received from customers in a given period. This would normally be a high number and would be different from the related revenue. Cash received from customers could be different from revenue, for example because part of the revenue in one period could be received in cash in the following period. A high number of cash received from customers would, however, not show whether trade receivables had increased or decreased, which was an interesting piece of information. He therefore preferred the indirect method. He nevertheless recommended the IASB not consider prohibiting presenting cash flows from operating activities using the direct method as discussions on this could be very time-consuming and it was, after all, a matter of taste.

**Mark Clatworthy** noted that cash flow information was often considered by academics as being much more objective than earnings. However, the panel discussion highlighted that there was much subjectivity involved in presenting cash flows, too. He asked what the next steps would be from EFRAG and the IASB.

**Rasmus Sommer** explained that the next steps from EFRAG on its proactive project on the statement of cash flows would be to issue a discussion paper. This would be done in Q4 of 2024. EFRAG would then summarise the comments it receives in response to that discussion paper and assess whether, based on the comments received, it would be possible for EFRAG to make some tentative recommendations to the IASB on what it should do as part of its project on the statement of cash flows.

**Ann Tarca** noted that the boundaries of the IASB's project on the statement of cash flows were not predetermined as they were in many other IASB's projects. Scoping the project would therefore be important for the IASB. For scoping the project, it was valuable for the IASB to receive as much information as possible on the existing issues. As part of the initial phase of the project, the IASB would also consider a literature review. If academics were aware of literature that would not be included in that review but that would be relevant for the IASB, they should let the IASB know about it. It was important for the IASB to understand the landscape, so academic literature, including descriptive statistics, would help the IASB understand aspects of the various issues. If academics were able to initiate some research that could be useful for the project, they should look at the

issues identified with the statement of cash flows as part of the IFRS 18 project. Relevant studies should be sent to academics@ifrs.org.

## Q&A session

### Expanding the scope of the changes

**A first participant** considered the distinction between operating, investing and financing activities to be the most important element in the statement of cash flows. Two entities could have the same cash flows, but the origins of the cash flows could be very different. It was therefore important for the IASB to keep that distinction. He asked whether the expansion of the scope of the changes included in the statement could be considered.

**Ann Tarca** replied that the IASB had introduced changes to IAS 7 by requiring information on changes in liabilities resulting from financing activities. The intention was that this could help users performing a net debt reconciliation, whether or not requiring a net debt reconciliation was nevertheless something that the IASB would discuss as part of its project.

### Depicting cash flows or changes in assets and liabilities

**A second participant** thought that, conceptually, a statement of cash flows should depict cash flows. Only by presenting cash flows from operating activities using the direct method would cash flows be depicted. Showing changes in working capital items under the indirect method could be very useful for investors, but that information could be included in disclosures. The participant suggested removing the options on how to present cash flows from interest and dividends. Finally, the participant found that what was 'cash and cash equivalents' differed between the statement of cash flows and the statement of financial position. The same terminology was used to depict different things. This difference should also be removed according to the participant.

**Martijn Bos** replied that the second participant's comment showed that there are different views on whether the indirect or the direct methods for presenting cash flows from operating activities are the most useful. He agreed that the direct method showed cash flows, but for him the most useful was to see the changes in the relevant assets and liabilities. For example, if the changes in account receivables was a high number, it indicated that he would have to find out what was going on. The indirect method, accordingly, had more of a signalling function.

**Tina Aggerholm** noted that showing the changes under the indirect method reflected how cash flows were managed by the entity. Entities were managing cash through its negotiations and agreements with suppliers and customers. By indicating the changes in relevant assets and liabilities, entities thereby show how they work with customers and suppliers. Just showing the payments did not provide any information on this, as the fluctuations in payments could be caused by many other factors. She thought that for the statement of cash flows to be useful for users it should reflect how a business is managed.

**Ann Tarca** noted, in response to the comment from the second participant on the options for categorising cash flows from interests and dividends, that with the introduction of IFRS 18 these options would be removed.

### **Providing new information**

**A third participant** thought that the information included in the statement of cash flows should be incremental in respect to the information included in the financial statements. Users of financial statements could reconstruct to an acceptable degree the cash flows from operating activities if prepared under the indirect method. If prepared under the direct method, the statement could add some incremental information. The participant asked what should be included in the statement of cash flows should it include additional information.

**Martijn Bos** remarked that, as he previously stated, the statement of cash flows is one of the pieces in a puzzle of three pieces. He could reconstruct the statement of cash flows himself based on other information included in the financial statements. However, he did not agree that the statement of cash flows should necessarily bring forth additional information. It would also be valuable if it would make the information included in financial statements more accessible for users. He explained that financial analysis was cumbersome and very costly and financial statements were still not very effective. This was illustrated by more and more money being invested passively as active management did not add sufficient value. One cause was that financial statements were not yet sufficiently informative to add further value. Financial information needed to be more readily accessible. Arguing that information did not have to be provided because users could derive it themselves was therefore ultimately not a good argument. Financial statements should instead be made more user-friendly for a large population of investors.